Supreme Court, U.S.
FILED

011574 APR 17 2002

OFFICE OF THE CLERK

No. _____

IN THE

Supreme Court of the United States

October Term, 2001

MARVIN L. BARMES and BARBARA J. BARMES,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Writ of Certiorari
To The United States Court of Appeals
For The Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

MARVIN L. BARMES
BARBARA J. BARMES
120 Main Street
Vincennes, IN 47591
Telephone: (812) 882-5605

130 pp

QUESTIONS PRESENTED

I. Whether the Seventh Circuit Panel erred by holding that the Fifth Amendment does not protect business documents, and then sanctioning Marvin and Barbara Barmes by deeming the Commissioner's factual averments admitted. More specifically, Justices Clarence Thomas and Antonin Scalia stated that "a substantial body of evidence suggests that the Fifth Amendment privilege protects against the compelled production not just of incriminating testimony, but of **any incriminating evidence**." A review of the period when the Fifth Amendment was drafted and ratified reveals substantial support for the view that the term "witness" meant a person who gives or furnishes evidence, a broader meaning than Supreme Court case law currently ascribes to the term.

LIST OF PARTIES

All parties appear in the capttion of the case on the cover page.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

LIST OF PARTIES ii

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES iv

OPINIONS BELOW 1

JURISDICTION 1

STATEMENT OF THE CASE 2

REASON FOR GRANTING THE WRIT 10

The Seventh Circuit Panel Erred Affirming The Tax Court Decision Applying The Collective Entity Rule To Defeat Valid Fifth Amendment Claims, And Sanctioning The Barmeses By Deeming The Commissioner's Factual Assertions Admitted 10

CONCLUSION 32

APPENDIX A
Decision of the Seventh Circuit Court of Appeals

APPENDIX B
Decision of the United States Tax Court

TABLE OF AUTHORITIES

Cases Page

Bellis v. United States,
417 U.S. 85 (1974) 13, 15

Boyd v. United States,
116 U.S. 616 (1886) 10, 15, 24, 25

Braswell v. United States,
487 U.S. 99 (1988) 13, 14

Counselman v. Hitchcock,
142 U.S. 547 (1892) 27, 28, 29

Curcio v. United States,
354 U.S. 118 (1957) 15

Fisher v. United States,
425 U.S. 391 (1975) 15

Hale v. Henkel,
201 U.S. 43 (1906) 14

Interstate Commerce Comm'n v. Baird,
194 U.S. 25 (1904) 30

United States v. Hubbell,
530 U.S. 27 (2000) 10, 11, 16, 20

United States v. Saline Bank,
26 U.S. 100 (1828) 23, 24

Wilson v. United States,
221 U.S. 361 (1911) 15

OPINIONS BELOW

The opinion of the Seventh Circuit Court of Appeals affirming the United States Tax Court's Opinion is reported on Lexis as *Marvin L. Barmes and Barbara J. Barmes v. Commissioner of Internal Revenue*, 2002 U.S. App. LEXIS 4807 (Seventh Circuit, February 25, 2002), and is reprinted in Appendix A.

The opinion of the United States Tax Court is reported as *Marvin L. Barmes and Barbara J. Barmes v. Commissioner of Internal Revenue*, T.C. Memo 2001-155; 2001 Tax Ct. Memo LEXIS 183; 81 T.C.M. (CCH) 1825 (Tax Court, June 28, 2001), and is reprinted in Appendix B.

JURISDICTION

The opinion of the Seventh Circuit Court of Appeals in this case, affirming the Tax Court's Opinion, was filed on February 25, 2002. This petition is therefore timely under Supreme Court Rules 13.1, 13.3, 29.2, & 30.1 if mailed U.S.P.S. first class, postmarked by May 26, 2002.

This Court has jurisdiction to review the judgment of the court of appeals pursuant to 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

On April 14, 1999, the Commissioner issued a notice of deficiency to Marvin L. and Barbara J. Barmes ("the Barmeses") for the tax year 1995. The Commissioner's deficiency asserted the Barmeses had unreported taxable income in the amount of $890,719.00. On June 24, 1999, the Barmeses filed a petition for redetermination with the United States Tax Court.

Until October 12, 1995,[1] the Barmeses owned Barbara's Gift Shop and Barmes Wholesale (the "business"), a wholesale and retail mail-order business. At that time the Barmeses ceased ownership and operation of the business, since it was transferred to Sandbar Wholesale Trust. The business had gross receipts of $4,217,962.00 for the year 1995 until the ownership was changed. By ignoring the change of ownership of the business and attributing the Commissioner's **estimate** of the gross earnings of the business for the entire 1995 calendar year, the Commissioner determined that the Barmeses had unreported income in the amount of $890,719.00.

In the notice of deficiency issued to the Barmeses for 1995, the Commissioner increased the 1995 Schedule C gross receipts, and consequently the Barmeses taxable income, by $890,719. The only basis upon which the Commissioner increased the Barmeses' gross receipts and concomitant taxable income was based upon extrapolations from their 1994 Form 1040 filed by the Barmeses. Exhibit C of the notice of deficiency explained in detail the method that the

---

1. Factual statements concern the tax year 1995 unless otherwise specified.

Commissioner used to determine the increase in the Barmeses' 1995 gross receipts from the 1994 return:

	December 31, 1994
Total expense per 1994 Form 1040 as originally filed	$ 1,871,671
Gross profit per 1994 Form 1040 as originally filed	2,624,759
Total expense to gross profit percentage (divide item 1 by 2)	71.31%
	December 31, 1995
Total expense per 1995 Form 1040 as originally filed	$ 1,973,107
Total expense to gross profit percentage (see above)	71.31%
Corrected gross profit (divide item 4 by 5)	2,766,943
Amount per return	1,876,224
Adjustment to income	890,719

In other words, the Commissioner reconstructed the Barmeses' Schedule C gross receipts by dividing the total expenses reported on the Barmeses' 1994 Schedule C (i.e., $1,871,671) by the gross profit (total net gross receipts (i.e., total gross receipts reduced by returns and allowances) minus

cost of goods sold) reported in that schedule (i.e., $2,624,759). The resulting quotient was 71.31 percent. The revenue agent then divided the total expenses claimed in the Barmeses' 1995 Schedule C (i.e., $1,973,107) by that percentage. The result ($2,766,943) was determined to be the reconstructed Schedule C gross profit for 1995. The Commissioner determined that the difference (i.e., $890,719) between that reconstructed gross profit of $2,766,943 and the gross profit reported in the Barmeses' 1995 Schedule C (i.e., $1,876,224) constituted their unreported 1995 Schedule C gross receipts. This is the only method used by the Commissioner for reconstructing the Barmeses' Schedule C gross receipts for 1995, which increased the 1995 Schedule C gross receipts by $890,719.

The Commissioner also determined in the notice that Barmeses were liable for 1995 for the accuracy-related penalty under section 6662(a).

The Commissioner served discovery requests on the Barmeses during the Tax Court proceedings. The Barmeses testified in their declaration filed with the trial court that they were appointed by the Trustees of Sandbar Wholesale and Sandbar Real Estate to open a bank account. Accounts were opened with Community Bank & Trust. The "Minutes of the Proceedings of the Respective Trustees ... Appointing the General Manager, and Authorization to Open and Sign on Bank Account" accepting the same duties and responsibilities as set forth for the trustees was limited to the bank account(s) as specifically set forth in that document.

The Barmeses testified that they do not have custody, possession, or control of the documents the Commissioner was seeking with the request for documents.

The Barmeses also testified that they attempted to obtain the documents the Commissioner was seeking with his request for documents, and that they were not able to obtain the documents.

The Barmeses further objected to responding to discovery by asserting their Fifth Amendment right on a question-by-question, document-by-document basis.

The Tax Court held that the Barmeses properly asserted their Fifth Amendment right not to respond to the interrogatories, but they did not have a Fifth Amendment right, pursuant to the collective entity rule, not to produce the documents. The Court sanctioned the Barmeses for their failure to comply with an Order of the Court with respect to discovery by producing the documents.[2] As a sanction, and with a few exceptions, the following facts alleged by the Commissioner were deemed true by the Tax Court:

> (a) On October 12, 1995, Marvin L. Barmes and Barbara J. Barmes established what purport to be "pure trusts" into which they, on or about October 12, 1995, purportedly transferred title to all their personal property, including their ownership interests in Marvin L. and Barbara J. Barmes, PTR, d.b.a. Barbara's Gift Shop, and d.b.a. Barmes Wholesale. The purported trusts are known as the Sandbar Real Estate Trust and the Sandbar Wholesale Trust.

---

2. The Tax Court also held that it could have imposed a sanction pursuant to Rule 104(c)(3) by rendering a judgment by default against the Barmeses, but proceeded with the trial nevertheless. The Barmeses assert that the results are the same as a judgment by default, since all factual assertions made by the Commissioner were deemed admitted.

(b) On October 18, 1995, Marvin L. Barmes and Barbara J. Barmes purportedly transferred title to three parcels of real estate to the Sandbar Real Estate Trust. These three parcels of real estate comprise all of the known real estate holdings of Marvin L. Barmes and Barbara J. Barmes, including their personal residence and the business location of Barbara's Gift Shop and Barmes Wholesale located at 114 and 120 Main Street in Vincennes, Indiana.

(c) Marvin L. Barmes and Barbara J. Barmes received no consideration in exchange for the purported transfer of property to the Sandbar Real Estate Trust and the Sandbar Wholesale Trust described in subparagraphs (a) and (b), above.

(d) Marvin L. Barmes and Barbara J. Barmes continued to operate and control the business known as Barbara's Gift Shop and Barmes Wholesale after the creation of the Sandbar Wholesale Trust, and have continued to enjoy the use of the parcels of real estate and the personal property after the purported transfers to the Sandbar Real Estate Trust.

(e) During 1995, the trustees of both the Sandbar Real Estate Trust and the Sandbar Wholesale Trust are as follows:

James Rabold, the brother of Barbara J. Barmes, and the petitioners' daughters-in-law Jennifer Burgess Barmes and Susan Thomas Barmes.

(f) Jennifer Burgess Barmes and Susan Thomas Barmes were employed by petitioners during 1995.

(g) Petitioners and the trustees of the Sandbar Real Estate Trust and the Sandbar Wholesale Trust have refused to provide to respondent's agents or officers information or documentation setting forth who the beneficiaries are of each trust.

(h) The Sandbar Wholesale Trust has not filed a Form 1041, U.S. Fiduciary Income Tax Return, for the tax year ended December 31, 1995.

(i) The taxpayer identification number used by the Sandbar Wholesale Trust, 52-9876145, is not a valid taxpayer identification number registered or otherwise recognized by the Internal Revenue Service.

(j) On March 14, 1996, petitioner Marvin L. Barmes, as the general manager of the Sandbar Wholesale Trust, executed under penalties of perjury Indiana State Form 11405, Business Tangible Personal Property Assessment Return, for the calendar year ended December 31, 1995.

(k) On the Indiana State Form 11405, Business Tangible Personal Property Assessment Return, the Sandbar Wholesale Trust, through its general manager, Marvin L. Barmes, stated that the trusts had total sales of $ 5,799,767.00 for the calendar year ended December 31, 1995, from the general retail and wholesale activities of Barbara's Gift Shop/Barmes Wholesale conducted at 120/114 Main Street in Vincennes, Indiana.

(l) On their personal income tax return for the tax year ended December 31, 1995, petitioners reported on Schedule C total gross receipts or sales of $ 4,217,062.00 for Barbara's Gift Shop and Barmes Wholesale conducted at

120 Main Street in Vincennes, Indiana.

(m) Petitioners have continued to control the operations of their businesses, Barbara's Gift Shop and Barmes Wholesale, since the creation of the Sandbar Wholesale Trust in October 1995.

(n) In the notice of deficiency, respondent determined that petitioners understated their net taxable income from their operation of Barbara's Gift Shop and Barmes Wholesale for the tax year ended December 31, 1995 by $ 890,719.00.

(o) Based on the adjustment of $ 890,719.00 to net profit for the tax year 1995 from petitioners' operation of Barbara's Gift Shop and Barmes Wholesale, respondent determined that petitioners had a net profit of $ 793,881.00, n9 not a net loss of $ 96,883.00, as claimed by petitioners.

(p) Utilizing the net profit percentage based on total sales from petitioners' 1994 personal income tax return of 13.83%, respondent determined petitioner's total sales for 1995 to be $ 5,740,282, as follows:

1995 net profit	$ 793,881.00	
divided [by] net profit percentage		13.83%
Gross Profit [sic]	$ 5,740,282.00	

(q) Based on total sales of $ 5,799,767.00 as reported by Marvin L. Barmes on the Indiana State Form 11405, Business Tangible Personal Property Assessment Return, for the calendar year ended December 31, 1995, and utilizing the net profit margin determined by respondent of 13.83 percent, net profit for from [sic] the operation of Barbara's Gift Shop and Barmes Wholesale for the tax year

ended December 31, 1995 was $ 802,108.00.

(r) The Sandbar Wholesale Trust is a mere sham for tax purposes and should be disregarded.

(s) The taxable income attributed by petitioners to the Sandbar Wholesale Trust for tax year 1995 is taxable to petitioners for the taxable year ended December 31, 1995.

On October 23, 2000, trial was held, and both parties filed post-trial briefs. On June 28, 2001, the Tax Court filed its Memorandum Opinion affirming the Commissioner's determination and sanctioning the Barmeses. On June 28, 2001, the Tax Court granted sanctions in favor of the Commissioner as set forth in the Memorandum Opinion, primarily for asserting their Fifth Amendment claims. On June 28, 2001, the Tax Court's Decision was entered.

On September 13, 2001, the Barmeses timely filed their notice of appeal in accordance with Rule 13(a)(1) of the Federal Rules of Appellate Procedure and § 7483, which allows ninety days after the decision is entered to file a notice of appeal. The Seventh Circuit had jurisdiction to review the Tax Court decision under § 7482.

On February 25, 2002, the panel affirmed the Tax Court. This timely petition follows.

REASON FOR GRANTING THE WRIT

I. The Seventh Circuit Panel Erred Affirming The Tax Court Decision Applying The Collective Entity Rule To Defeat Valid Fifth Amendment Claims, And Sanctioning The Barmeses By Deeming The Commissioner's Factual Assertions Admitted.

The collective entity rule, and the act-of-production doctrine, constitute express departures from the holding of the Supreme Court in *Boyd v. United States*, 116 U.S. 616 (1886). Justices Thomas and Scalia have recently invited a case to return to the analysis of *Boyd*:

> I join the opinion of the Court because it properly applies [the act-of-production] doctrine, but I write separately to note that this doctrine may be inconsistent with the original meaning of the Fifth Amendment's Self-Incrimination Clause. A substantial body of evidence suggests that the Fifth Amendment privilege protects against the compelled production not just of incriminating testimony, but of **any incriminating evidence**. In a future case, I would be willing to reconsider the scope and meaning of the Self-Incrimination Clause.

United States v. Hubbell, 530 U.S. 27 (2000), 120 S. Ct. 2037, 2050, 147 L. Ed. 2d 24, 44 (2000) (Thomas, J., & Scalia, J., concurring).

This is that case!

Justices Thomas and Scalia noted that:

> None of this Court's cases, however, has undertaken an analysis of the meaning of the term at the time of the founding. A review of that period reveals substantial support for the view that the term "witness" meant a person who gives or furnishes evidence, a broader meaning than that which our case law currently ascribes to the term. If this is so, a person who responds to a subpoena duces tecum would be just as much a "witness" as a person who responds to a subpoena ad testificandum.

Id.

A review of the historical underpinnings of the adoption of the Fifth Amendment prove that, at the time of its adoption, no person, even one in a collective capacity, could be compelled to produce documents in his possession or control, even if not belonging to him, if the document would provide a lead, link, or clue that might subject him to criminal prosecution.

Justices Thomas' and Scalia's historical analysis proves that the term "witness," as used in the Fifth Amendment, includes those who "give evidence" as well as those who give oral testimony. *Hubbell*, 120 S. Ct. at 2050-54, 147 L. Ed. 2d at 44-48 (Thomas, J., & Scalia, J., concurring). The cases cited and arguments made by Justices Thomas and Scalia, which the Barmeses will not reproduce here for brevity sake, make clear that it is immaterial whether or not the witness may hold evidence in a representative capacity, a witness simply could not be compelled to give evidence against himself at the time the Fifth Amendment was adopted. Id.

On October 13, 2000, the Tax Court issued an Order granting in part and denying in part the Commissioner's motion to compel production of documents. On the same date, the Tax

Court issued a separate Order denying the Commissioner's motion to compel answers to the Commissioner's interrogatories. The Commissioner conceded, and the Tax Court concurred, that the Barmeses' reliance on the Fifth Amendment to the Constitution in support of their refusal to answer those interrogatories was warranted, since the Commissioner was contemplating or anticipating the possibility of a future criminal investigation of the Barmeses.

The Tax Court's Order granting in part the Commissioner's motion to compel production of documents directed Appellants to produce to counsel for the Commissioner those documents requested in the Commissioner's request for production of documents. This was directed at the requested business documents.

The Seventh Circuit Panel affirmed the Tax Court's imposition of sanctions against the Barmeses pursuant to Rule 104(c) of the Tax Court Rules and Procedures by ruling that the Barmeses violated the Order of the Court with respect to discovery by not producing the business documents. The Barmeses assert that the Fifth Amendment protected them from producing documents when considered in light of the original intent of the Founding Fathers. The Commissioner was only able to prevail in this matter due to the Seventh Circuit Panel's affirmation of the Tax Court ruling that the facts asserted in paragraph 7 of the Commissioner's Answer were deemed true by sanctioning the Barmeses under Rule 104(c).

The Seventh Circuit Panel found that "the Tax Court held that as managers of business organizations ... the Barmeses could not invoke this constitutional privilege either directly (to shield the contents of the documents) or indirectly (to shield the act of production and the implication of authenticity). See

Braswell v. United States, 487 U.S. 99 (1988). When the Barmeses still refused to comply, the Tax Court drew an adverse inference (i.e., that the documents would support the Commissioner's position) and not only sustained the Commissioner's assessment but also added sanctions for taking a frivolous position in the litigation. 81 T.C.M. 1825 (2001). Like the Tax Court, we deem the Barmeses' position frivolous. The principle that an organization's managers cannot invoke the privilege with respect to its documents is well established and governs even when the business is a partnership and the link between organizational and personal culpability is correspondingly tight. See *Bellis v. United States*, 417 U.S. 85 (1974)."

The Request for Documents was so Broad that Any Response Would be "Testimonial"

Background

On September 25, 2000, the Tax Court issued an Order stating that the Commissioner "shall inform the Court whether either petitioner has been notified that he or she is the target of any grand jury proceeding or any other criminal investigation, whether either petitioner is currently, or has ever been, the subject of any criminal tax or other criminal investigation, and/or whether a criminal tax or other criminal investigation of either petitioner is contemplated or anticipated."

United States filed a response to the Order and admitted it contemplates or anticipates pursuing criminal tax or other criminal investigation of the Barmeses in the future. United States' response was quoted in the Tax Court's Order of October 4, 2000. United States admitted in its reply brief that the Barmeses were correct that the Fifth Amendment was

properly invoked by them. United States concession was memorialized in the Tax Court's Order of October 13, 2000.

On October 13, 2000, the Tax Court granted in part and denied in part the Commissioner's motion to compel production of documents. The Tax Court found that the Fourth and Fifth Amendments did not protect the production of documents.

Under current case authority, the documents the Commissioner was seeking may be considered to come within the collective entity rule, and the businesses' documents will come under the act-of-production doctrine.

The collective entity rule had its genesis in *Hale v. Henkel*, 201 U.S. 43, 70-75 (1906), which held that "an officer or employee of a corporation" summoned before a grand jury as a witness could not "refuse to produce the books and documents of such corporation upon the ground that they would incriminate the corporation itself." *Hale*, 201 U.S. at 74; *Braswell v. United States*, 487 U.S. 99, 105 (1988). The Court reasoned that because a corporation "is a creature of the State," *id.*, with powers limited by the State, that the State may, in the exercise of its right to oversee the corporation, demand to see corporate records. *Hale*, 201 U.S. at 75; *Braswell*, 487 U.S. at 105.

As to the argument that the officer could refuse to produce the corporate documents because they would incriminate him personally, the Court rejected the argument as "untenable" because the officer was **immunized** "by reason of the immunity act of 1903." *Hale*, 201 U.S. at 70 & 73; *Braswell*, 487 U.S. at 105.

The *Hale* Court would have prohibited non-immunized,

compelled, production of personally incriminating documents because it had relied on *Boyd v. United States*, 116 U.S. 616 (1886), as a decision that "exhaustively considered" the matter. *Hale*, 201 U.S. at 71. *Boyd*, in turn, had held that the compulsory production by a partner of a partnership invoice that could be used against the partner violated the Fifth Amendment. *Boyd*, 116 U.S. at 618-634.

From these meager beginnings, the collective entity rule has been expanded to such an extent that the courts now allow the United States to compel production of documents belonging to any "organized, institutional activity" even when those documents will incriminate the natural person being forced to produce them. See, generally, *Braswell*, 487 U.S. 99 and *Bellis v. United States*, 417 U.S. 85 (1974). The methodology for this change from *Boyd* was creating a distinction between documents held in a representative rather than personal capacity, and limiting the protection of the Fifth Amendment to the latter. *Wilson v. United States*, 221 U.S. 361, 384-85 (1911).

The collective agent, however, still retains full Fifth Amendment protection as to any "oral testimony," *Curcio v. United States*, 354 U.S. 118, 124 (1957), and cannot be compelled to "testify orally as to the whereabouts of nonproduced records." *Curcio*, 354 U.S. at 128.

The next departure from *Boyd* was the creation of the doctrine that the Fifth Amendment does not "proscribe the compelled production of every sort of incriminating evidence[,] but applies only when the accused is compelled to make a testimonial communication that is incriminating." *Fisher v. United States*, 425 U.S. 391 (1975). The Court rejected *Boyd*'s holding that the documents themselves are protected by the

Fifth Amendment, and simultaneously created the "act-of-production doctrine, which provides that persons compelled to turn over incriminating papers or other physical evidence . . . may invoke the Fifth Amendment privilege against self-incrimination as a bar to production only where the act of producing the evidence would contain 'testimonial' features." *United States v. Hubbell*, 530 U.S. 27, 120 S. Ct. 2037, 2050, 147 L. Ed. 2d 24, 44 (2000) (Thomas, J., & Scalia, J., concurring).

Thus, we have three principles to apply: (1) under the collective entity rule, a collective agent cannot interpose the Fifth Amendment privilege to the production of the collective's documents based on the fact that the documents will personally incriminate him; (2) any person, however, can interpose the privilege against giving incriminating oral testimony; and (3) any person can interpose the privilege to the production of documents where the act of producing the evidence contains "testimonial features." Principles two and three are, in a sense, the same because, as shown below, the underpinning of rule three is that testimonial productions are equivalent to oral testimony for Fifth Amendment purposes.

The latest Supreme Court case to discuss the act-of-production doctrine was *Hubbell*, 530 U.S. 27, 120 S. Ct. 2037, 147 L. Ed. 2d 24. Hubbell was subpoenaed to produce, and did produce under a grant of immunity, documents responsive to eleven categories of documents:

> "A. Any and all documents reflecting, referring, or relating to any direct or indirect sources of money or other things of value receive by or provided to Webster Hubbell, his wife, or children from January 1, 1993 to the present, including but not limited to the identity of employers or

clients of legal or any other type of work.

"B. Any and all documents reflecting, referring, or relating to any direct or indirect sources of money of other things of value received by or provided to Webster Hubbell, his wife, or children from January 1, 1993 to the present, including but not limited to billing memoranda, draft statements, bills, final statements, and/or bills for work performed or time billed from January 1, 1993 to the present.

"C. Copies of all bank records of Webster Hubbell, his wife, or children for all accounts from January 1, 1993 to the present, including but not limited to all statements, registers and ledgers, cancelled checks, deposit items, and wire transfers.

"D. Any and all documents reflecting, referring, or relating to time worked or billed by Webster Hubbell from January 1, 1993 to the present, including but not limited to original time sheets, books, notes, papers, and/or computer records.

"E. Any and all documents reflecting, referring, or relating to expenses incurred by and/or disbursements of money by Webster Hubbell during the course of any work performed or to be performed by Mr. Hubbell from January 1, 1993 to the present.

"F. Any and all documents reflecting, referring, or relating to Webster Hubbell's schedule of activities, including but not limited to any and all calendars, day-timers, time books, appointment books, diaries, records of reverse telephone toll calls, credit card calls, telephone

message slips, logs, other telephone records, minutes, databases, electronic mail messages, travel records, itineraries, tickets for transportation of any kind, payments, bills, expense backup documentation, schedules, and/or any other document or database that would disclose Webster Hubbell's activities from January 1, 1993 to the present.

"G. Any and all documents reflecting, referring, or relating to any retainer agreements or contracts for employment of Webster Hubbell, his wife, or his children from January 1, 1993 to the present.

"H. Any and all tax returns and tax return information, including but not limited to all W-2s, form 1099s, schedules, draft returns, work papers, and backup documents filed, created or held by or on behalf of Webster Hubbell, his wife, his children, and/or any business in which he, his wife, or his children holds or has held an interest, for the tax years 1993 to the present.

"I. Any and all documents reflecting, referring, or relating to work performed or to be performed or on behalf of the City of Los Angeles, California, the Los Angeles Department of Airports or any other Los Angeles municipal Governmental entity, Mary Leslie, and/or Alan S. Arkatov, including but not limited to correspondence, retainer agreements, contracts, time sheets, appointment calendars, activity calendars, diaries, billing statements, billing memoranda, telephone records, telephone message slips, telephone credit card statements, itineraries, tickets for transportation, payment records, expense receipts, ledgers, check registers, notes, memoranda, electronic mail, bank deposit items, cashier's checks, traveler's checks, wire transfer records and/or other records of financial

transactions.

"J. Any and all documents reflecting, referring, or relating to work performed or to be performed by Webster Hubbell, his wife, or his children on the recommendation, counsel or other influence of Mary Leslie and/or Alan S. Arkatov, including but not limited to correspondence, retainer agreements, contracts, time sheets, appointment calendars, activity calendars, diaries, billing statements, billing memoranda, telephone records, telephone message slips, telephone credit card statements, itineraries, tickets for transportation, payment records, expense receipts, ledgers, check registers, notes, memoranda, electronic mail, bank deposit items, cashier's checks, traveler's checks, wire transfer records and/or other records of financial transactions.

"K. Any and all documents related to work performed or to be performed for or on behalf of Lippo Ltd. (formerly Public Finance (H.K.) Ltd.), the Lippo Group, the Lippo Bank, Mochtar Riady, James Riady, Stephen Riady, John Luen Wai Lee, John Huang, Mark W. Grobmyer, C. Joseph Giroir, Jr., or any affiliate, subsidiary, or corporation owned or controlled by or related to the aforementioned entities or individuals, including but not limited to correspondence, retainer agreements, contracts, time sheets, appointment calendars, activity calendars, diaries, billing statements, billing memoranda, telephone records, telephone message slips, telephone credit card statements, itineraries, tickets for transportation, payment records, expense receipts, ledgers, check registers, notes, memoranda, electronic mail, bank deposit items, cashier's checks, traveler's checks, wire transfer records and/or other records of financial transactions." App. 47-49.

Hubbell, 120 S. Ct. at 2040 & 2049-50, 147 L. Ed. 2d at 32-33 & 42-44.

Analyzing whether the Fifth Amendment privilege "protects the act of production itself," *Hubbell*, 120 S. Ct. at 2044, 147 L. Ed. 2d at 37, the Supreme Court held:

> Compelled testimony that communicates information that may "lead to incriminating evidence" is privileged even if the information itself is not inculpatory.

Hubbell, 120 S. Ct. at 2044, 147 L. Ed. 2d at 38.

> [I]t is **undeniable** that providing a catalog of existing documents fitting within **any** of the 11 broadly worded subpoena categories could provide a prosecutor with a "lead to incriminating evidence" or "a link in the chain of evidence needed to prosecute."

Hubbell, 120 S. Ct. at 2046, 147 L. Ed. 2d at 39 (emphasis added).

> Given the breadth of the description of the 11 categories of documents called for by the subpoena, the collection and **production of the materials demanded was tantamount to answering a series of interrogatories asking a witness to disclose the existence and location of particular documents fitting certain broad descriptions**. The assembly of literally hundreds of pages of material in response to a request for "any and all documents reflecting, referring, or relating to any direct or indirect sources of money or other things of value received by or provided to" an individual or members of his family during a 3-year period, Appendix, infra, at 19, **is the functional equivalent**

> **of the preparation of an answer to** either a detailed written interrogatory or **a series of oral questions at a discovery deposition**.

Hubbell, 120 S. Ct. at 2046, 147 L. Ed. 2d at 39 (emphasis added).

> For these reasons, we cannot accept the Government's submission that respondent's immunity did not preclude its derivative use of the produced documents because its "possession of the documents [was] the fruit only of a simple physical act – the act of producing the documents. It was unquestionably necessary for respondent to make extensive use of "the contents of his own mind" in identifying the hundreds of documents responsive to the requests in the subpoena. See *Curcio v. United States*, 354 U.S. 118, 128, 1 L. Ed. 2d 1225, 77 S. Ct. 1145 (1957); *Doe v. United States*, 487 U.S. at 210. The assembly of those documents was like telling an inquisitor the combination to a wall safe, not like being forced to surrender the key to a strongbox. 487 U.S. at 210, n. 9. **The Government's anemic view of respondent's act of production as a mere physical act that is principally non-testimonial in character** and can be entirely divorced from its "implicit" testimonial aspect so as to constitute a "legitimate, wholly independent source" (as required by Kastigar) for the documents produced **simply fails to account for these realities**.

Hubbell, 120 S. Ct. at 2047, 147 L. Ed. 2d at 40 (emphasis added).

> Given our conclusion that respondent's act of production had a testimonial aspect, at least with respect to

> the existence and location of the documents sought by the Government's subpoena, respondent could not be compelled to produce those documents without first receiving a grant of immunity.

Hubbell, 120 S. Ct. at 2048, 147 L. Ed. 2d at 41.

Thus, the Supreme Court held that the broad production requested by the *Hubbell* subpoena was equivalent to oral testimony and, therefore, subject to full protection under the privilege. The documents sought by the Commissioner in his request for documents served on the Barmeses were as broad as those in *Hubbell*. Thus, the inescapable conclusion is that the request is the functional equivalent of incriminating oral testimony.

As discussed above, even a collective agent cannot be compelled to give incriminating oral testimony. Therefore, as to the business documents, the Barmeses could not be compelled to answer the discovery, absence a grant of immunity, even assuming that the businesses are collective entities and the Barmeses are members or officers thereof. As to the sole proprietor records of the businesses, the same result is mandated. Accordingly, the Tax Court, and the Seventh Circuit Panel's affirmation thereof, erred by requiring production of documents and imposing sanctions pursuant to Rule 104(c).

The Collective Entity Rule and Act-Of-Production Doctrine Violate the Fifth Amendment and must be Overruled

As mentioned above, the collective entity rule and the act-of-production doctrine constitute express departures from the

holding of *Boyd*. Justices Thomas and Scalia have recently invited a case to return to the analysis of *Boyd*. *Hubbell*, 120 S. Ct. at 2050, 147 L. Ed. 2d at 44 (Thomas, J., & Scalia, J., concurring). Justices Thomas and Scalia noted that Supreme Court cases have not undertaken an analysis of the meaning of the term "witness" in the Fifth Amendment at the time of the founding. *Id.*

A review of the historical underpinnings of the adoption of the Fifth Amendment prove that, at the time of its adoption, no person, even one in a collective capacity, could be compelled to produce documents in his possession or control, even if not belonging to him, if the document would provide a lead, link, or clue that might subject him to criminal prosecution. Justices Thomas' and Scalia's historical analysis proves that the term "witness," as used in the Fifth Amendment, includes those who "give evidence" as well as those who give oral testimony. *Hubbell*, 120 S. Ct. at 2050-54, 147 L. Ed. 2d at 44-48 (Thomas, J., & Scalia, J., concurring). The cases cited and arguments made by Justices Thomas and Scalia make clear that it is immaterial whether or not the witness may hold evidence in a representative capacity, a witness simply could not be compelled to give evidence against himself at the time the Fifth Amendment was adopted. *Id.*

The Supreme Court upheld the Fifth Amendment right as to collective agents for over a hundred years. The first Supreme Court case to address the question was *United States v. Saline Bank*, 26 U.S. 100, 1823 U.S. LEXIS 393 (1828). There, a company was formed by a number of persons to carry on the business of banking. *Saline Bank*, 1823 U.S. LEXIS at *1. In a bill of equity, the plaintiffs sought discovery from the bank's cashier and stockholders to be used against them personally. *Saline Bank*, 1823 U.S. LEXIS at *4-5. The employee and

stockholders argued that they could not be compelled to give discovery "whereby they may impeach or accuse themselves of an offence or crime." *Saline Bank*, 1823 U.S. LEXIS at *5. The Supreme Court held:

> This is a bill in equity for a discovery and relief. The defendants set up a plea in bar, alleging that the discovery would subject them to penalties under the statute of Virginia.
>
> The Court below decided in favour of the validity of the plea, and dismissed the bill.
>
> It is apparent that in every step of the suit, the facts required to be discovered in support of this suit would expose the parties to danger. **The rule clearly is, that a party is not bound to make any discovery which would expose him to penalties**, and this case falls within it.
>
> The decree of the Court below is therefore affirmed.

Saline Bank, 26 U.S. at 104 (entire opinion, emphasis added).

The next case to examine the question was *Boyd*, 116 U.S. 616. There, partners in E.A. Boyd & Sons claimed that they could not constitutionally be compelled to produce a partnership invoice on the grounds that it could be used against them. *Boyd*, 116 U.S. at 618-19. Recognizing the gravity of the constitutional question the Court stated:

> As the question raised upon the order for the production by the claimants of the invoice of the twenty-nine cases of glass, and the proceedings had thereon, is not only an important one in the determination of the present case, but

> is a very grave question of constitutional law, involving the personal security, and privileges and immunities of the citizen, we will set forth the order at large.

Boyd, 116 U.S. at 618. After an exhaustive analysis of the historical underpinnings of the Fifth Amendment, the Court held:

> The views of the first Congress on the question of compelling a man to produce evidence against himself may be inferred from a remarkable section of the judiciary act of 1789. The 15th section of that act introduced a great improvement in the law of procedure. The substance of it is found in § 724 of the Revised Statutes, and the section as originally enacted is as follows, to wit:
>
> > "All the said courts of the United States shall have power in the trial of actions at law, on motion and due notice thereof being given, to require the parties to produce books or writings in their **possession or power**, which contain evidence pertinent to the issue, in cases and under circumstances where they might be compelled to produce the same by the ordinary rules of proceeding in chancery; and if a plaintiff shall fail to comply with such order to produce books or writings, it shall be lawful for the courts respectively, on motion, to give the like judgment for the defendant as in cases of nonsuit; and if a defendant shall fail to comply with such order to produce books or writings, it shall be lawful for the courts respectively, on motion as aforesaid, to give judgment against him or her by default." *
>
> * Note by the Court. -- Sixty-two years later a similar

act was passed in England, viz., the act of 14 and 15 Vict., c. 99, § 6. See Pollock on Power of Courts to compel production of Documents, 5.

The restriction of this proceeding to "cases and under circumstances where they [the parties] might be compelled to produce the same [books or writings] by the ordinary rules of proceeding in chancery," shows the wisdom of the Congress of 1789. The court of chancery had for generations been weighing and balancing the rules to be observed in granting discovery on bills filed for that purpose, in the endeavor to fix upon such as would best secure the ends of justice. To go beyond the point to which that court had gone may well have been thought hazardous. Now it is elementary knowledge, that one cardinal rule of the court of chancery is never to decree a discovery which might tend to convict the party of a crime, or to forfeit his property. And any compulsory discovery by extorting the party's oath, or compelling the production of his private books and papers, to convict him of crime, or to forfeit his property, is contrary to the principles of a free government. It is abhorrent to the instincts of an Englishman; it is abhorrent to the instincts of an American. It may suit the purposes of despotic power; but it cannot abide the pure atmosphere of political liberty and personal freedom.

Boyd, 116 U.S. 630-32 (emphasis added).

Clearly, the underlying principle is that no person can be compelled to "give discovery" that would incriminate him. The act of the first Congress specifically held the privilege was applicable to books or writings in a persons' "**possession or power**;" which the *Boyd* Court described as "private books and papers." Thus, the *Boyd* Court was quite correct to apply the

privilege to a partnership invoice in the hands of an individual. The government simply cannot compel the production of papers from the hands of a person who would be incriminated thereby. "A witness, as well as a party, is protected by the law from being compelled to give evidence that tends to criminate him." *Boyd*, 116 U.S. at 638.

The Court also noted that when the infirmity of the 1863 and 1867 acts in question were "brought to the attention of Congress," Congress passed an act in 1868 giving immunity to persons required to give discovery **or evidence** against themselves. *Boyd*, 116 U.S. at 632.

The Supreme Court's later decisions which assign a contrary meaning to "private books and papers," to justify the collective entity rule, simply ignore (1) the historical rationale of the privilege, (2) *Boyd*'s use of the phrase to describe all books or writings in a persons "possession or power," and (3) the fact that *Boyd* applied the privilege to a collective entity's invoice.

The next case to discuss the meaning of the Fifth Amendment was *Counselman v. Hitchcock*, 142 U.S. 547 (1892). There the Court held that before the government may compel a person to be a witness against himself under a grant of statutory immunity, the statute must "supply a complete protection from all the perils against with the constitutional prohibition was designed to guard." *Counselman*, 142 U.S. at 586 (holding the immunity statue insufficient). After exhaustively reviewing the historical underpinnings of the Fifth Amendment and analyzing state court decisions interpreting similar clauses in their constitutions, the Court held:

> This review of the cases above referred to shows that in

the constitutions of Georgia, California and New York the provision is identically or substantially that of the Constitution of the United States, namely, that no person shall "be compelled in any criminal case to be a witness against himself;" while in the constitutions of Pennsylvania, Arkansas, Indiana, Massachusetts, Virginia, New Hampshire and North Carolina it is different in language, and to the effect that "no man can be compelled to give evidence against himself;" or that, in prosecutions, the accused "shall not be compelled to give evidence against himself;" or that "no person in any criminal prosecution shall be compelled to testify against himself;" or that no person shall be "compelled to accuse or furnish evidence against himself;" or that no man can "be compelled to give evidence against himself;" or that, in all criminal prosecutions, "every man has the right to not be compelled to give evidence against himself."

But, as the manifest purpose of the constitutional provisions, both of the States and of the United States, is to prohibit the compelling of testimony of a self-criminating kind from a party or a witness, the liberal construction which must be placed upon constitutional provisions for the protection of personal rights would seem to require that the constitutional guaranties, however differently worded, should have as far as possible the same interpretation; and that where the constitution, as in the cases of Massachusetts and New Hampshire, declares that the subject shall not be "compelled to accuse or furnish evidence against himself," such a provision should not have a different interpretation from that which belongs to constitutions like those of the United States and of New York, which declare that no person shall be "compelled in any criminal case to be a witness against himself." Under the rulings above referred

> to, by Chief Justice Marshall and by this court, and those in Massachusetts, New Hampshire, and Virginia, the judgment of the Circuit Court in the present case cannot be sustained. It is a reasonable construction, we think, of the constitutional provision, that the witness is protected "from being compelled to disclose the circumstances of his offence, the sources from which, or the means by which, evidence of its commission, or of his connection with it, may be obtained, or made effectual for his connection, without using his answers as direct admissions against him." Emery's Case, 107 Mass. 172, 182.
>
> It is contended on the part of the appellee that the reason why the courts in Virginia, Massachusetts and New Hampshire have held that the exonerating statute must be so broad as to give the witness complete amnesty, is that the constitutions of those States give to the witness a broader privilege and exemption than is granted by the Constitution of the United States, in that their language is that the witness shall not be compelled to accuse himself, or furnish evidence against himself, or give evidence against himself; and it is contended that the terms of the Constitution of the United States, and of the constitutions of Georgia, California and New York are more restricted. But **we are of opinion that**, however this difference may have been commented on in some of the decisions, **there is really, in spirit and principle, no distinction arising out of such difference of language**.

Counselman, 142 U.S. at 584-86 (emphasis added).

Thus, the privilege is an absolute prohibition against, absent full immunity, compelling a person to "furnish evidence against himself."

In *Interstate Commerce Comm'n v. Baird*, 194 U.S. 25, (1904), corporate officers refused to produce corporate records on the ground that it "would be to compel the witnesses to furnish evidence against themselves . . . in violation of the Fifth Amendment." *Baird*, 194 U.S. at 43-45. The Court held:

> As to the constitutional objection based upon the Fifth Amendment, the act as amended February 11, 1893, expressly extends immunity from prosecution or forfeiture of estate because of testimony given in pursuance of the requirements of law.

Baird, 194 U.S. at 45. The rule that you could not compel a man to give evidence, any evidence, against himself was so obvious that the Court used the term "testimony" as shorthand for producing corporate documents.

As previously noted, in *Hale*, 201 U.S. at 70 & 73, the Court rejected the claim that a corporate officer could refuse to produce corporate documents on the ground that the documents would incriminate him because the officer had statutory immunity; not on the basis of the collective entity rule.

In *Wilson v. United States*, 221 U.S. 361, 377-85 (1911), the Supreme Court extended the collective entity rule to corporate documents that incriminate the corporate officer personally, and limited the application of *Boyd* to private (now meaning "not corporate") books and records. Thus, the Court, for the first time, ruled that a person can constitutionally be compelled to produce incriminating evidence against himself.

In *Fisher v. United States*, 425 U.S. 391, 408 (1976), the Court abandoned *Boyd* altogether, permitting the United States to compel a person to furnish any incriminating document and

protecting only the "testimonial" aspects of that transfer.

Hale, *Wilson*, *Fisher*, and their progeny are simply inconsistent with the original meaning of the Fifth Amendment. "It is an ancient principle of the law of evidence, that a witness shall not be compelled, in any proceeding, to make disclosures or to give testimony which will tend to criminate or subject to fines, penalties or forfeitures." *Counselman*, 142 U.S. at 563-64. It is time to accept Justices Thomas and Scalia's challenge to return to the reasoned, exhaustive, analysis of *Boyd* and end the barbarity of compelling citizens of the United States to provide evidence against themselves.

Therefore, discovery of the business documents under the collective entity rule and the sole proprietor businesses records under the act-of-production doctrine are prohibited by the Fifth Amendment. Accordingly, the Seventh Circuit Panel's affirmation of the Tax Court's ruling which ordered the Barmeses to produce documents, and sanctioning them pursuant to Rule 104(c) when they did not, must be reversed.

Because the Seventh Circuit Court of Appeals failed to properly apply the correct interpretation of the Fifth Amendment, ignored Supreme Court Justice's Thomas' and Scalia's scholarly analysis, and the historic underpinning of the Fifth Amendment, a writ of *certiorari* should issue to correct the judgment.

CONCLUSION

For each and all of the above grounds, a writ of certiorari should issue.

The decisions below should be reversed.

Respectfully submitted,

MARVIN L. BARMES
BARBARA J. BARMES
120 Main Street
Vincennes, IN 47591
Telephone: (812) 882-5605

April 12, 2002.

APPENDIX A

MARVIN L. BARMES and BARBARA J. BARMES, Petitioners-Appellants, v. COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

No. 01-3517

UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

2002 U.S. App. LEXIS 4807

February 21, 2002 *, Submitted

* After an examination of the briefs and the record, we have concluded that oral argument is unnecessary, and the appeal is submitted on the briefs and the record. See Fed. R. App. P. 34(a); Cir. R. 34(f).

February 25, 2002, Decided

NOTICE:

RULES OF THE SEVENTH CIRCUIT COURT OF APPEALS MAY LIMIT CITATION TO UNPUBLISHED OPINIONS. PLEASE REFER TO THE RULES OF THE UNITED STATES COURT OF APPEALS FOR THIS CIRCUIT.

PRIOR HISTORY:

Appeal from the United States Tax Court. No. 11486-99. Carolyn P. Chiechi, Judge.

Barmes v. Comm'r, 2001 Tax Ct. Memo LEXIS 183, T.C. Memo. 2001-155, T.C.M. (RIA) P 54384, 81 T.C.M. (CCH) 1825 (June 28, 2001).

DISPOSITION:
AFFIRMED.

COUNSEL:

MARVIN L. BARMES, Petitioner - Appellant, Pro se, Vincennes, IN USA.

BARBARA J. BARMES, Petitioner - Appellant, Pro se, Vincennes, IN USA.

For COMMISSIONER OF INTERNAL REVENUE, Respondent - Appellee: Joel L. McElvain, DEPARTMENT OF JUSTICE, Washington, DC USA.

JUDGES:

Before Hon. RICHARD A. POSNER, Circuit Judge, Hon. FRANK H. EASTERBROOK, Circuit Judge, Hon. KENNETH F. RIPPLE, Circuit Judge.

OPINION:

Order

In October 1995 Marvin and Barbara Barmes transferred their home and their retail business to newly formed trusts. They retained control over these trusts, and thus over the income generated by their business, but have taken the position that the trust device ended their obligation to pay federal income taxes.

Neither the Barmeses nor the trusts reported any income for the period after the transfer. This is in accord with advice furnished by Lynne Meredith, whose organization "Sovereignty Pure Trusts" drew up the documents that the Barmeses used. But Meredith's advice is not sound. A person who generates income and retains effective control remains liable for taxes; indeed, even a person who in advance divests all control over income must pay taxes as if the income had been received and given away. See *Lucas v. Earl*, 281 U.S. 111, 74 L. Ed. 731, 50 S. Ct. 241 (1930). Relying on this principle, the Commissioner of Internal Revenue determined that the Barmeses had underreported their 1995 income by about $ 890,000 and assessed appropriate taxes (about $ 315,000) plus about $ 63,000 in penalties for the substantial understatement of tax liability. See *26 U.S.C. § 6662*(a).

The Barmeses complicated litigation in the Tax Court by refusing to produce any documents concerning the trusts' income. They contended that the fifth amendment's self-incrimination clause entitles them to keep trust information secret, but the Tax Court held that as managers of business organizations (that is to say, the trusts) the Barmeses could not invoke this constitutional privilege either directly (to shield the contents of the documents) or indirectly (to shield the **[*3]** act of production and the implication of authenticity). See *Braswell v. United States,* 487 U.S. 99, 101 L. Ed. 2d 98, 108 S. Ct. 2284 (1988). When the Barmeses still refused to comply, the Tax Court drew an adverse inference (*i.e.*, that the documents would support the Commissioner's position) and not only sustained the Commissioner's assessment but also added sanctions for taking a frivolous position in the litigation. 81 T.C.M. 1825 (2001).

Like the Tax Court, we deem the Barmeses' position frivolous. The principle that an organization's managers cannot invoke the privilege with respect to its documents is well established and

governs even when the business is a partnership and the link between organizational and personal culpability is correspondingly tight. See *Bellis v. United States*, 417 U.S. 85, 40 L. Ed. 2d 678, 94 S. Ct. 2179 (1974). The principle that people cannot avoid taxes by assigning their income and assets to third parties also is well established. See *United States v. Basye*, 410 U.S. 441, 35 L. Ed. 2d 412, 93 S. Ct. 1080 (1973); *CIR v. Culbertson*, 337 U.S. 733, 93 L. Ed. 1659, 69 S. Ct. 1210 (1949); *Lucas v. Earl, supra.* These principles dictate the outcome of this case and require us to affirm the Tax Court. The Barmeses should count themselves fortunate that the Commissioner did not ask for additional sanctions in this court.

AFFIRMED

APPENDIX B

MARVIN L. BARMES AND BARBARA J. BARMES, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

No. 11486-99

UNITED STATES TAX COURT

T.C. Memo 2001-155; *2001 Tax Ct. Memo LEXIS 183; 81 T.C.M. (CCH) 1825*

June 28, 2001, Filed

DISPOSITION:

An appropriate order will be issued and a decision will be entered sustaining respondent's determinations and imposing a penalty under section 6673(a)(1).

COUNSEL:

Marvin L. Barmes and Barbara J. Barmes, pro sese.

Timothy A. Lohrstorfer, for respondent.

JUDGES:

Chiechi, Carolyn P.

OPINION BY:

CHIECHI

OPINION:

CHIECHI, JUDGE: Respondent determined a deficiency in, and an accuracy-related penalty under section 6662(a) n1 on, petitioners' Federal income tax for 1995 in the amounts of $ 315,478 and $ 63,095.60, respectively.

----------Footnotes----------

n1 Unless otherwise indicated, all section references are to the Internal Revenue Code (Code) in effect for the year at issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

----------End Footnotes----------

The issues remaining for decision n2 are:

(1) Did petitioners have unreported taxable income for 1995 in the amount of $ 890,719? We hold that they did.

----------Footnotes----------

n2 Certain computational issues also remain for 1995, resolution of which flows automatically from our resolution of the determinations in the notice that we address herein.

----------End Footnotes----------

(2) Are petitioners entitled to the depreciation deductions that they claimed for 1995 with respect to two automobiles? We hold that they are not.

(3) Are petitioners liable for the accuracy-related penalty under section 6662(a)? We hold that they are.

(4) Should the Court impose on petitioners a penalty under section 6673(a)(1)? We hold that we should, and we shall impose such a penalty in the amount of $ 2,000.

RESPONDENT'S MOTION TO IMPOSE SANCTIONS

On October 13, 2000, we issued an Order (October 13, 2000 Order) granting in part and denying in part respondent's motion to compel production of documents (respondent's motion to compel). n3 In that Order, we directed petitioners to produce to counsel for respondent on or before October 19, 2000, those documents requested in respondent's request for production of documents (the requested trust n4 documents), which we considered to be documents of Sandbar Wholesale Trust and/or Sandbar Real Estate Trust. n5 (We shall refer collectively to Sandbar Wholesale Trust and Sandbar Real Estate Trust as the trusts.) The requested trust documents with respect to each of those trusts that the October 13, 2000 Order directed petitioners to produce included, inter alia, the trust agreement with any amendments from tax year 1995 to the present, the certificates of beneficial interest issued by the trust during or otherwise effective for tax year 1995, any agreements between the trust and either petitioner or both petitioners with respect to the use of the trust assets by either or both of them, any compensation agreements between petitioner Marvin Barmes (Mr. Barmes) and the trust for tax years 1995 to the present, all capital unit certificates issued by the trust from tax year 1996 to the present, all trust accounting books and records for the period beginning with the trust's purported creation through December 31, 1995, all trust documents pertaining to distributions from the trust for the period beginning with the trust's purported creation to the present, and certain trust bank account information.

----------Footnotes----------

n3 In a separate Order issued on Oct. 13, 2000, we denied respondent's motion to compel answers to respondent's interrogatories. That was because respondent had conceded, and we agreed, that petitioners' reliance on the Fifth Amendment to the Constitution (Fifth Amendment) in support of their refusal to answer those interrogatories was warranted, since respondent was contemplating or anticipating the possibility of a future criminal investigation of petitioners.

n4 When referring in this Opinion to Sandbar Wholesale Trust and/or Sandbar Real Estate Trust, our use of the words "trust", "trusts", "trustees", "general managers", "certificates of beneficial interest", "capital unit certificates", and similar terms is for convenience only and is not intended to convey any meaning or have any significance for Federal income tax purposes.

n5 In the October 13, 2000 Order, we sustained petitioners' Fifth Amendment claim and denied respondent's motion to compel insofar as that motion pertained to those documents requested in respondent's request for production of documents, which we did not consider to be documents of Sandbar Wholesale Trust and/or Sandbar Real Estate Trust.

----------End Footnotes----------

Petitioners objected on the following grounds (petitioners' objections) to the production of the documents requested in respondent's request for production of documents: (1) Relevancy with respect to any documents requested regarding Sandbar Real Estate Trust; (2) petitioners' lack of custody, possession, or control over the documents requested in respondent's request for production of documents, if any such documents existed; (3) relevancy with respect to any documents requested for any tax periods other than 1995; and (4) the Fifth

Amendment. In the October 13, 2000 Order, we considered and rejected each of the first three of petitioners' objections. In that Order, we considered and (1) sustained petitioners' Fifth Amendment claim insofar as it related to the production of petitioners' personal documents and (2) rejected that claim insofar as it related to the production of the requested trust documents.

In the October 13, 2000 Order, we cautioned petitioners that we would be inclined to impose sanctions under Rule 104(c) in the event that petitioners did not fully comply with the provisions of that Order requiring them to produce to counsel for respondent the requested trust documents.

On October 18, 2000, petitioners filed a motion to reconsider the October 13, 2000 Order (petitioners' motion to reconsider). In that motion, petitioners advanced essentially the same arguments which they had advanced in opposing respondent's motion to compel and which we rejected in the October 13, 2000 Order. On October 18, 2000, we denied petitioners' motion to reconsider.

On October 23, 2000, this case was called from the calendar (calendar call) at the Court's trial session in Indianapolis, Indiana. At the calendar call, petitioners requested that the Court schedule the trial in this case on that day. At the calendar call, counsel for respondent informed the Court that petitioners had failed to comply with the October 13, 2000 Order and filed respondent's motion to impose sanctions (respondent's motion for sanctions). In that motion, respondent requested the Court to impose on petitioners pursuant to Rule 104(c) one or more sanctions because of their failure to comply with the October 13, 2000 Order.

We asked petitioners at the calendar call whether they had complied with the October 13, 2000 Order. Petitioners replied

that they had not, but that they had filed with the Court petitioners' motion to reconsider. We reminded petitioners that we had denied petitioners' motion to reconsider. We then directed petitioners to produce the requested trust documents to counsel for respondent as soon as possible before trial and advised petitioners that we would impose sanctions on them if they failed to do so. At the conclusion of the calendar call, we informed the parties that we were taking respondent's motion for sanctions under advisement, and we restated that if petitioners did not produce the requested trust documents prior to the commencement of the trial in this case, the Court would impose sanctions on them because of their failure to do so.

Thereafter on October 23, 2000, this case was recalled from the calendar for trial (recall of this case). At that recall, we asked petitioners whether they had complied with the October 13, 2000 Order. Petitioners stated that they had not complied with that Order and began to reassert as an objection to the production of the requested trust documents that they did not have custody or control over such documents. At the recall of this case, we reminded petitioners that the Court had previously rejected that contention in the October 13, 2000 Order. We also rejected that contention in our denial of petitioners' motion to reconsider. We advised petitioners at the recall of this case that we considered them to be willfully failing to comply with the October 13, 2000 Order.

We asked petitioners at the recall of this case whether they had any response to respondent's motion for sanctions. Petitioners replied by reasserting their Fifth Amendment claim as an objection to the production of the requested trust documents. We reminded petitioners at the recall of this case that in the October 13, 2000 Order the Court had carefully considered and rejected petitioners' Fifth Amendment claim insofar as it pertained to the requested trust documents, and we

again asked petitioners whether they had any response to respondent's motion for sanctions. Petitioners stated that they did not have any response to that motion.

Thereafter, at the recall of this case, we proceeded with the trial without acting on respondent's motion for sanctions, which remained under advisement. We proceeded with the trial without acting on that motion because, although we had informed petitioners at the calendar call and at the recall of this case that we would impose sanctions on them for their failure to comply with the October 13, 2000 Order, we had not had adequate time as of the beginning of the trial in this case to consider and decide what sanction(s) we would impose on petitioners.

Although not requested by the Court, on October 31, 2000, petitioners submitted, and the Court had filed, petitioners' response (petitioners' response) to respondent's motion for sanctions. In petitioners' response, petitioners reasserted essentially most of the same arguments that they had advanced in opposition to respondent's motion to compel, which we rejected in the October 13, 2000 Order, and that they had continued to advance in petitioners' motion to reconsider, which we denied on October 18, 2000.

In petitioners' response to respondent's motion for sanctions, petitioners also advanced an argument under the Fourth Amendment to the Constitution (Fourth Amendment). According to petitioners, *Boyd v. United States, 116 U.S. 616, 29 L. Ed. 746, 6 S. Ct. 524 (1886),* holds that an individual may not be compelled to produce his "private papers to establish a criminal charge against him, or to forfeit his property", *id. at 622,* and that no negative inferences may be drawn from such individual's failure to do so, see *id. at 621-622.* Petitioners' reliance on Boyd is misplaced. That case involved the requested production of certain private books and papers of the claimants

in the context of a forfeiture action by the United States. See *id. at 622, 624.* The United States Supreme Court (Supreme Court) held that both the Fourth Amendment and the Fifth Amendment prohibited the production of those private items in a forfeiture proceeding. n6 See *id. at 634-635.*

----------Footnotes----------

n6 Although the Supreme Court acknowledged that a forfeiture suit by the United States was technically a civil proceeding, it characterized such an action as "in substance and effect a criminal one". *Boyd v. United States, 116 U.S. 616, 634, 29 L. Ed. 746, 6 S. Ct. 524 (1886).* The Supreme Court stated with respect to such suits:

we think that they are within the reason of criminal proceedings for all the purposes of the Fourth Amendment of the Constitution, and of that portion of the Fifth Amendment which declares that no person shall be compelled in any criminal case to be a witness against himself; and we are further of [the] opinion that a compulsory production of the private books and papers of the owner of goods sought to be forfeited in such a suit is compelling him to be a witness against himself, within the meaning of the Fifth Amendment to the Constitution, and is the equivalent of a search and seizure -- and an unreasonable search and seizure -- within the meaning of the Fourth Amendment. * * *

Id. at 634-635. In contrast to the forfeiture action considered by the Supreme Court in Boyd, the instant case is a civil proceeding and may not in any way be characterized as criminal in nature.

----------End Footnotes----------

In the instant case, the requested trust documents are not the private books and papers of petitioners. Rather, they are the documents of Sandbar Wholesale Trust and/or Sandbar Real Estate Trust, for which petitioners were appointed general managers and managing agents and, as such, had the same duties and responsibilities as the respective trustees of the trusts. That distinction is critical as far as the Supreme Court is concerned. In *United States v. White, 322 U.S. 694, 88 L. Ed. 1542, 64 S. Ct. 1248 (1944),* the Supreme Court distinguished *Boyd v. United States, supra,* in cases where, as here, the requested documents are not those belonging to the individual personally but are those that the individual holds in his or her capacity as a representative of a so-called collective entity. The Supreme Court stated: "individuals, when acting as representatives of a collective group, cannot be said to be exercising their personal rights and duties nor to be entitled to their purely personal privileges." *Id. at 699* (distinguishing *Boyd v. United States, supra).* On the instant record, we find that petitioners, as the appointed general managers and managing agents of both Sandbar Wholesale Trust and Sandbar Real Estate Trust, have no valid claims under the Fourth Amendment that would prevent production of the requested trust documents. n7

----------Footnotes----------

n7 Nor would we find on the instant record that petitioners have a valid claim under the Fourth Amendment assuming arguendo that the requested trust documents were petitioners' private documents, rather than trust documents. "Requiring taxpayers, who institute civil proceedings protesting deficiency notices, to produce records or face dismissal constitutes no invasion of privacy or unlawful search or seizure." *Edwards v. Commissioner, 680 F.2d 1268, 1270 (9th Cir. 1982),* affg. per

curiam an order of dismissal; see *Coulter v. Commissioner, 82 T.C. 580, 583 (1984); Ebert v. Commissioner, T.C. Memo. 1991-629,* affd. per unpublished order *1993 U.S. App. LEXIS 3576* (10th Cir., Feb. 23, 1993). Of course, we previously found on the record before us that petitioners did have a valid claim for protection under the Fifth Amendment with respect to the production of their personal documents. See supra note 5; see also supra note 3.

----------End Footnotes----------

Based on our examination of the record before us, we find that petitioners have willfully failed to comply with the October 13, 2000 Order and that they never had any intention of complying with that Order. We further find that petitioners' willful flouting of the October 13, 2000 Order hampered respondent's ability to develop respondent's position in this case with respect to, inter alia, the determination in the notice to increase petitioners' Schedule C gross receipts for 1995.

Rule 104(c) provides that if a party fails to obey an order of the Court with respect to the provisions of, inter alia, Rule 72 relating to production of documents and things, the Court may make such orders as to the failure as are just. Such orders may include, but are not limited to,

(1) An order that the matter regarding which the order was made or any other designated facts shall be taken to be established for the purposes of the case in accordance with the claim of the party obtaining the order.

* * * * *

(3) An order * * * dismissing the case or any part thereof, or

rendering a judgment by default against the disobedient party.

Rule 104(c)(1), (3).

In the instant case, respondent alleged the following in paragraph 7 of respondent's answer:

(a) On October 12, 1995, Marvin L. Barmes and Barbara J. Barmes established what purport to be "pure trusts" into which they, on or about October 12, 1995, purportedly transferred title to all their personal property, including their ownership interests in Marvin L. and Barbara J. Barmes, PTR, d nba Barbara's Gift Shop, and d nba Barmes Wholesale. The purported trusts are known as the Sandbar Real Estate Trust and the Sandbar Wholesale Trust.

(b) On October 18, 1995, Marvin L. Barmes and Barbara J. Barmes purportedly transferred title to three parcels of real estate to the Sandbar Real Estate Trust. These three parcels of real estate comprise all of the known real estate holdings of Marvin L. Barmes and Barbara J. Barmes, including their personal residence and the business location of Barbara's Gift Shop and Barmes Wholesale located at 114 and 120 Main Street in Vincennes, Indiana.

(c) Marvin L. Barmes and Barbara J. Barmes received no consideration in exchange for the purported transfer of property to the Sandbar Real Estate Trust and the Sandbar Wholesale Trust described in subparagraphs (a) and (b), above.

(d) Marvin L. Barmes and Barbara J. Barmes continued to operate and control the business known as Barbara's Gift Shop and Barmes Wholesale after the creation of the Sandbar Wholesale Trust, and have continued to enjoy the use of the parcels of real estate and the personal property after the

purported transfers to the the [sic] Sandbar Real Estate Trust.

(e) During 1995, the trustees of both the Sandbar Real Estate Trust and the Sandbar Wholesale Trust are as follows: James Rabold, the brother of Barbara J. Barmes, [n8] and the petitioners' daughters-in-law Jennifer Burgess Barmes and Susan Thomas Barmes.

----------Footnotes----------

n8 The parties stipulated that during the year at issue James Rabold was married to Carol Barmes, who is Mr. Barmes' sister. James Rabold is the brother-in-law, and not the brother, of Barbara J. Barmes. As corrected, par. 7(e) of respondent's answer should read as follows:

(e) During 1995, the trustees of both the Sandbar Real Estate Trust and the Sandbar Wholesale Trust are as follows: James Rabold, petitioners' brother-in-law, and the petitioners' daughters-in-law Jennifer Burgess Barmes and Susan Thomas Barmes.

----------End Footnotes----------

(f) Jennifer Burgess Barmes and Susan Thomas Barmes were employed by petitioners during 1995.

(g) Petitioners and the trustees of the Sandbar Real Estate Trust and the Sandbar Wholesale Trust have refused to provide to respondent's agents or officers information or documentation setting forth who the beneficiaries are of each trust.

(h) The Sandbar Wholesale Trust has not filed a Form 1041, U.S. Fiduciary Income Tax Return, for the tax year ended

December 31, 1995.

(i) The taxpayer identification number used by the Sandbar Wholesale Trust, 52-9876145, is not a valid taxpayer identification number registered or otherwise recognized by the Internal Revenue Service.

(j) On March 14, 1996, petitioner Marvin L. Barmes, as the general manager of the Sandbar Wholesale Trust, executed under penalties of perjury Indiana State Form 11405, Business Tangible Personal Property Assessment Return, for the calendar year ended December 31, 1995.

(k) On the Indiana State Form 11405, Business Tangible Personal Property Assessment Return, the Sandbar Wholesale Trust, through its general manager, Marvin L. Barmes, stated that the trusts had total sales of $ 5,799,767.00 for the calendar year ended December 31, 1995, from the general retail and wholesale activities of Barbara's Gift Shop/Barmes Wholesale conducted at 12

(l) On their personal income tax return for the tax year ended December 31, 1995, petitioners reported on Schedule C total gross receipts or sales of $ 4,217,062.00 for Barbara's Gift Shop and Barmes Wholesale conducted at 120 Main Street in Vincennes, Indiana.

(m) Petitioners have continued to control the operations of their businesses, Barbara's Gift Shop and Barmes Wholesale, since the creation of the Sandbar Wholesale Trust in October 1995.

(n) In the notice of deficiency, respondent determined that petitioners understated their net taxable income from their operation of Barbara's Gift Shop and Barmes Wholesale for the

tax year ended December 31, 1995 by $ 890,719.00.

(o) Based on the adjustment of $ 890,719.00 to net profit for the tax year 1995 from petitioners' operation of Barbara's Gift Shop and Barmes Wholesale, respondent determined that petitioners had a net profit of $ 793,881.00, n9 not a net loss of $ 96,883.00, as claimed by petitioners.

----------Footnotes----------

n9 Par. 7(o) of respondent's answer contains a mathematical error. As corrected, such par. should read as follows:

(o) Based on the adjustment of $ 890,719.00 to net profit for the tax year 1995 from petitioners' operation of Barbara's Gift Shop and Barmes Wholesale, respondent determined that petitioners had a net profit of $ 793,836.00, not a net loss of $ 96,883.00, as claimed by petitioners.

----------End Footnotes----------

(p) Utilizing the net profit percentage based on total sales from petitioners' 1994 personal income tax return of 13.83%, respondent determined petitioner's total sales for 1995 to be $ 5,740,282, as follows:

----------Footnotes----------

n10 Par. 7(p) of respondent's answer shows the 1995 net profit shown in par. 7(o). As we indicated supra note 9, par. 7(o) of respondent's answer contains a mathematical error. As Corrected, the 1995 net profit is $ 793,836. As Corrected, par. 7(p) of respondent's answer should read as follows:

(p) Utilizing the net profit percentage based on total sales from

petitioners' 1994 personal income tax return of 13.83%, respondent determined petitioner's total sales for 1995 to be $ 5,739,957, as follows:

----------End Footnotes----------

(q) Based on total sales of $ 5,799,767.00 as reported by Marvin L. Barmes on the Indiana State Form 11405, Business Tangible Personal Property Assessment Return, for the calendar year ended December 31, 1995, and utilizing the net profit margin determined by respondent of 13.83 percent, net profit for from [sic] the operation of Barbara's Gift Shop and Barmes Wholesale for the tax year ended December 31, 1995 was $ 802,108.00.

(r) The Sandbar Wholesale Trust is a mere sham for tax purposes and should be disregarded.

(s) The taxable income attributed by petitioners to the Sandbar Wholesale Trust for tax year 1995 is taxable to petitioners for the taxable year ended December 31, 1995.

Where, as here, there is a failure to comply with an Order of the Court with respect to discovery, we may impose such sanctions as we deem appropriate. See Rule 104(c); *Durovic v. Commissioner, 84 T.C. 101, 119 (1985); Marcus v. Commissioner, 70 T.C. 562, 571 (1978),* affd. without published opinion *621 F.2d 439 (5th Cir. 1980).* In respondent's motion for sanctions, respondent requests, inter alia, that the Court deem established for purposes of the instant case the allegations in paragraph 7(a) through 7(s) of the answer. We find such a sanction to be appropriate under the circumstances presented here, n11 except that we do not consider it appropriate to deem paragraph 7(r) and 7(s) of the answer to be established. That is

because those subparagraphs contain allegations that we find to be mixed allegations of fact and law. We shall grant respondent's motion in that the allegations in respondent's answer contained in paragraph 7(a) through 7(d), 7(e) as corrected to reflect the parties' stipulation, see supra note 8, 7(f) through 7(n), 7(o) and 7(p) with the mathematical errors corrected, see supra notes 9 and 10, and 7(q) are deemed established as facts for purposes of this case. n12 See Rule 104(c)(1); see also *Durovic v. Commissioner, supra at 119; Marcus v. Commissioner, supra at 577.*

----------Footnotes----------

n11 Rendering a judgment by default against petitioners in this case is a sanction that also is available to us under Rule 104(c)(3). See Rule 104(c)(3); see also *Rechtzigel v. Commissioner, 79 T.C. 132, 139-140,* (1982), affd. per curiam on other grounds *703 F.2d 1063 (8th Cir. 1983).* However, we shall not impose such a sanction here since we proceeded with the trial in this case on Oct. 23, 2000.

n12 The trial record in this case also establishes as facts many of the allegations that, pursuant to Rule 104(c)(1), we are deeming established as facts for purposes of this case.

----------End Footnotes----------

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. As discussed above, certain other facts have been deemed established pursuant to Rule 104(c) and are incorporated herein as findings of fact by this reference.

Petitioners, who at all relevant times were husband and wife, resided in Indiana at the time the petition was filed.

PETITIONERS' BUSINESSES

At all relevant times, petitioners operated two businesses, one under the name Barbara's Gift Shop and the other under the name Barmes Wholesale (collectively, the two businesses). During at least the period November 1994 through December 1996, Mr. Barmes was the individual who had ultimate control over Barbara's Gift Shop and Barmes Wholesale and the operations of those two businesses.

At all relevant times, Barbara's Gift Shop, a retail business located at 120 Main Street, n13 Vincennes, Knox County, Indiana, and Barmes Wholesale, a wholesale business located at 114 Main Street, Vincennes, Knox County, Indiana (collectively, the business locations), sold many of the same products, which included adult novelties and tobacco accessories. At those times, the respective buildings in which petitioners conducted the two businesses consisted of at least two floors, and above Barbara's Gift Shop were an apartment and offices. n14 At all relevant times, one or two buildings were located on Main Street between the respective business locations of Barbara's Gift Shop and Barmes Wholesale.

----------Footnotes----------

n13 The record is unclear as to whether the street on which the two businesses were located was called Main Street or East Main Street. Most of the references in the record are to Main Street, and, for convenience, we shall refer to the street on which the two businesses were located as Main Street.

n14 The record does not disclose whether the apartment and the offices located above Barbara's Gift Shop were separate and whether those offices served as offices for Barbara's Gift Shop only or for both Barbara's Gift Shop and Barmes Wholesale.

----------End Footnotes----------

On October 12, 1995, Mr. Barmes advised the respective employees n15 of Barbara's Gift Shop and Barmes Wholesale (collectively, business employees) (1) that the two businesses had become part of a trust and (2) that, after October 12, 1995, the business employees would no longer be employees of petitioners but would be independent contractors for Sandbar Wholesale Trust.

----------Footnotes----------

n15 When referring in this Opinion to the individuals who worked at the two businesses, our use of the words "employees", "independent contractors", "employer", and similar terms is for convenience only and is not intended to convey any meaning or have any significance for Federal tax purposes.

----------End Footnotes----------

In a written notice to the business employees dated November 2, 1995, Mr. Barmes informed such employees that, as of November 1, 1995, Barbara's Gift Shop and Barmes Wholesale would no longer carry Workman's Compensation Insurance.

On October 20, 1995, Mr. Barmes issued a written statement (October 20, 1995 written statement) to the business employees, which stated in pertinent part:

To all Workers:

From Marvin Barmes, General Manager

You will receive a W-2 for the period worked for Marvin Barmes (Barbara's Gift Shop/Barmes Wholesale), January 1, 1995 thru October 12, 1995.

On October 12, 1995, Barbara's Gift Shop and Barmes Wholesale businesses became part of a Trust. All workers were hired on by the Trust.

The Trust will issue 1099s for your worked [sic] performed thereafter.

All workers will be responsible for any/all taxes owed. Some may be required to file quarterly taxes. You may want to consult your tax preparer, CPA or call IRS at 1-800-829-1040.

An additional 25 cents will be added to your hourly compensation, effective on compensation starting October 15, 1995.

* * * * *

This is your last paycheck from Marvin L. Barmes, Sr.

Your vacation check is for accrued vacation pay.

Your next checks will be from the Trust, as compensation for your work.

"WORK FOR HIRE STATEMENT"

Clarifying the status of the worker!!!

1. Supervisors have the right to approve the end product.

2. Don't require salesperson to collect money from accounts on behalf of the *dba.

3. Don't provide *dba car, business cards, samples, stationary [sic], and/or reimburse rent.

4. Workers are not required to work exclusively for the *dba.

5. Don't provide workers with insurance benefits.

6. Worker's hourly pay is subject to the work performed.

7. Workers are not entitled to participate in any *dba plans, arrangements or distributions pertaining to any health, bonus, pension, stock, profit-sharing or similar benefits.

8. Workers will not be given paid vacations.

9. When you need a day(s) or week(s) off. [sic] Please give a few days notice to your supervisor so they [sic] can have a worker prepared to do your job.

*dba refers to Barbara's Gift Shop/Barmes Wholesale.

At the bottom of the October 20, 1995 written statement was a blank space at which Mr. Barmes instructed each of the business employees to sign his or her name as an indication that each such employee had read and understood that written statement.

In addition to requiring the business employees to sign the October 20, 1995 written statement, Mr. Barmes required them to sign and, in certain instances, to complete certain other forms, including a document entitled "Affidavit of Citizenship and Domicile" (citizenship affidavit form) and Form W-8,

Certificate of Foreign Status. The citizenship affidavit form stated in pertinent part:

I was not born in a territory over which the United States is Sovereign and I am, therefore, not subject to its jurisdiction and I am not a citizen of the United States, as defined in 26 CFR Sec. 1.1-1(c). I am not liable for the Title 26, Internal Revenue Code (IRC), Subtitle A, [Sec.] 1 graduated income taxes for reason of my alienage[.]

* * * * *

I am a sovereign Citizen of one of the 50 contiguous states of America, under the Constitution and the Law.

As such, I am a "Nonresident Alien" as such 'word of art' is defined in *IRC Sec. 7701(b)(1)(B)* under United States Tax Laws [Title 26 United States Code and the Internal Revenue Code]

26 CFR Sec 31.3401(a)(6)-1(b) "Remuneration paid to a nonresident alien individual . . . is exempted from wages and hence is not subject to withholding."

Petitioners issued to Susan Thomas Barmes and to Jennifer Burgess n16 Form W-2, Wage and Tax Statement (Form W-2), for the respective wages that they earned for the period January 1, 1995, through October 12, 1995. As of October 23, 2000, the date of the trial in this case, petitioners, Sandbar Wholesale Trust, and Sandbar Real Estate Trust had not issued to the business employees Forms W-2 or Forms 1099-MISC, Miscellaneous Income (or any other type of Form 1099), for any periods after 1995.

----------Footnotes----------

n16 During the year at issue, Susan Thomas Barmes and Jennifer Burgess were petitioners' daughters-in-law.

----------End Footnotes----------

PETITIONERS' REAL PROPERTIES

At all relevant times until at least October 12, 1995, petitioners owned the two parcels of real property on which the business locations were situated. At those times, petitioners also owned approximately 17.73 acres of land located at 6393 E. Overhead Road, Fritchton, Indiana (the Fritchton property), which was approximately 6.5 miles from the business locations. Petitioners' personal residence and an old farmhouse (old farmhouse) were situated on the Fritchton property. In 1994, petitioners remodeled the old farmhouse and furnished it as an office.

PETITIONERS' BANK ACCOUNTS

At least during 1994 and 1995, petitioners owned and maintained several bank accounts at Community Bank and Trust (Community Bank).

On October 13, 1995, Mr. Barmes completed five separate applications (account applications) in order to open five separate accounts with Community Bank, into each of which he made an initial cash deposit of $ 1,000. Each account application required Mr. Barmes to provide the name and the taxpayer identification number (TIN) of the account owner. Mr. Barmes provided the following names and TIN's in the respective account applications that he completed: (1) Sandbar Wholesale Trust -- Barbara [sic] Gift Shop, TIN 52-9876145; (2) Sandbar Family Trust, TIN 52-9876111; (3) Sandbar Wholesale Trust -- Barmes Wholesale, TIN 52-9876145; (4)

Sandbar Wholesales [sic] Trust -- Payroll, TIN 52-9876140; and (5) Sandbar Real Estate Trust, TIN 52-9876125.

Respondent did not issue TIN's 52-9876145 and 52-9876125. As of the date of the trial in this case, respondent had not issued employer identification numbers (EIN's) to Sandbar Wholesale Trust or Sandbar Real Estate Trust.

In completing the five separate account applications, Mr. Barmes provided certain other information to Community Bank with respect to each account. In each account application, Mr. Barmes indicated that he was opening the account for a personal purpose and not a business purpose, that only one signature was to be required in order for withdrawals to be made from the account, and that the account owner was a trust.

In the case of an account's being opened for a trust as owner of the account, the account application requested information as to the names and the addresses of the beneficiaries of the trust and whether the trust was a revocable trust or whether it had a pay- on-death designation. Mr. Barmes did not provide that information on any of the account applications that he completed.

In a section marked "BACKUP WITHHOLDING CERTIFICATIONS", the account application requested that the account owner certify under penalties of perjury that the TIN provided on the application was the correct TIN for that account owner and, if applicable, that the account owner certify that such account owner was not subject to backup withholding, was an exempt recipient, and/or was a nonresident alien. In each account application, Mr. Barmes indicated on behalf of the account owner, which in each instance he claimed was a trust, that the TIN provided in such application was the correct TIN for the trust, that the trust was not subject to backup withholding, and that the trust was not a United States person.

Mr. Barmes signed each of the account applications that he completed under penalties of perjury, thereby certifying under such penalties that the foregoing information that he provided on behalf of the account holder in each such application was correct. Below Mr. Barmes' signature in each account application, Mr. Barmes wrote the words "Without prejudice".

As of October 13, 1995, Community Bank listed (October 13, 1995 signature card) the following individuals as having signatory authority (signatories) over various separate Community Bank accounts maintained under the respective names Sandbar Real Estate Trust, Sandbar Wholesale Trust, n17 Sandbar Family Trust, and Land Vehicle Trust: n18 Marvin L. Barmes, Barbara Barmes, Marvin Barmes, Jr., Greg Barmes, Mark Barmes, Brian Barmes, Susan Thomas Barmes, Jennifer Burgess Barmes, and James Rabold. n19 The October 13, 1995 signature card identified Marvin L. Barmes as general manager and Susan Thomas Barmes, Jennifer Burgess Barmes, and James Rabold as trustees.

----------Footnotes----------

n17 Mr. Barmes opened three different accounts under the respective names Sandbar Wholesale Trust -- Barbara's Gift Shop, Sandbar Wholesale Trust -- Barmes Wholesale, and Sandbar Wholesale Trust -- Payroll. The record does not disclose whether the individuals listed as signatories for the three accounts maintained under the name Sandbar Wholesale Trust were signatories for all three of those accounts.

n18 The record does not disclose that an account was opened at Community Bank under the name Land Vehicle Trust.

n19 Marvin Barmes, Jr., Greg Barmes, Mark Barmes, and Brian Barmes are sons of petitioners. During the year at issue,

Susan Thomas Barmes was married to Greg Barmes, Jennifer Burgess Barmes was married to Mark Barmes, and James Rabold was married to Carol Barmes, who is Mr. Barmes' sister.

----------End Footnotes----------

As of March 27, 1996, Community Bank listed (March 27, 1996 signature card) the following individuals as signatories for various Community Bank accounts maintained under the respective names Sandbar Real Estate Trust, Sandbar Wholesale Trust, Sandbar Family Trust, and Sandbar Land Vehicle Trust: n20 Marvin L. Barmes, Barbara Barmes, Marvin Barmes, Jr., Greg Barmes, Mark Barmes, Brian Barmes, Susan Thomas Barmes, Kim Hall Barmes, n21 and James Rabold. The March 27, 1996 signature card identified Marvin L. Barmes as general manager and Susan Thomas Barmes, Kim Hall Barmes, and James Rabold as trustees.

----------Footnotes----------

n20 The record does not disclose that an account was opened at Community Bank under the name Sandbar Land Vehicle Trust.

n21 Kim Hall Barmes married Brian Barmes on June 3, 1995.

----------End Footnotes----------

As of May 28, 1998, Community Bank listed (May 28, 1998 signature card) the following individuals as signatories for Community Bank account number 020005325-6 that was maintained under the name Sandbar Wholesale Trust -- Barbara's Gift Shop: Marvin L. Barmes, Sr., Barbara Barmes,

Greg Barmes, Brian Barmes, Susan Thomas Barmes, Kim Hall Barmes, and James Rabold. The May 28, 1998 signature card identified Marvin L. Barmes, Sr. and Barbara Barmes as general managers and Susan Thomas Barmes, Kim Hall Barmes, and James Rabold as trustees.

SOVEREIGNTY PURE TRUSTS

At all relevant times, Sovereignty Pure Trusts (Sovereignty) was an entity that drafted for a fee so-called "Pure Trust Organizations" (pure trust organizations). At those times, Sovereignty sold pure trust organizations through promotional materials. The promotional materials used by Sovereignty during the year at issue were substantially the same as those that it used during 1998 (Sovereignty promotional materials). The Sovereignty promotional materials identified an individual named Lynne Meredith as the person who drafted the pure trust organization documents that were sold by Sovereignty. Those materials stated: "Your customized Pure Trust Organization(s) will be mailed within 15 WORKING DAYS from the date that we receive your completed application."

Under the heading "ADVANTAGES OF A PURE TRUST ORGANIZATION", the Sovereignty promotional materials stated in pertinent part:

1. NO INCOME TAX REQUIREMENTS! As verified by the I.R.S., "A PURE TRUST ORGANIZATION HAS NO TAX REQUIREMENTS!" * * * A Pure Trust is not required to pay income tax on its earnings, gains or profits. It does not file a tax return!

2. COMPLETE PRIVACY. A Pure Trust Organization holds assets, conducts business, and does banking in complete privacy. IT IS NOT REQUIRED TO HAVE A SOCIAL

SECURITY, E.I.N, OR OTHER FEDERAL IDENTIFICATION NUMBER! Information about the assets, liabilities, and management of Pure Trust Organizations are completely confidential and are not accessible to the government or to the public.

3. IRONCLAD ASSET PROTECTION! A Pure Trust Organization protects property from unscrupulous judgment creditors, tax liens, levies and seizures, lawsuits, divorce claims and bankruptcy.

4. FREEDOM: A Pure Trust Organization is Free from Legislative Restrictions!

a) The Pure Trust has NO accounting, bookkeeping or reporting requirements.

b) The Pure Trust has NO Income Tax Withholding or Social Security requirements.

c) The Pure Trust has NO quarterly tax payment or reporting requirements.

5. ELIMINATION OF PROBATE AND INHERITANCE TAXES. A Pure Trust is not required to pay Probate, Inheritance and Death Taxes and associated Legal Fees. A Pure Trust Organization is unaffected by the death of the Trustees or Beneficiaries.

6. MAINTAIN BENEFITS OF PROPERTY AND BUSINESS OWNERSHIP WITHOUT THE POTENTIAL LIABILITIES! Trustees and Beneficiaries are not liable for the debts of the Pure Trust Organization and Pure Trust Organization CANNOT be invaded because of any

debt incurred by the Trustees or Beneficiaries.

$ 695 First Pure Trust Organization - $ 595 Each Additional Trust Liberty International Program - $ 1650 for (3) Pure Trusts Pays for itself in Legal Tax Savings Less than the Cost of a Corporation! [Reproduced literally.]

Under the heading "Pure Trust Organization Information", the Sovereignty promotional materials stated in pertinent part:

The best time for estate planning and asset protection is NOW, BEFORE you need it. A Pure Trust Organization provides the surest road to freedom permitted by law, providing the ultimate in tax immunity, ironclad asset protection, privacy and estate planning. By transferring assets into properly structured Pure Trust Organizations, you can maintain complete control of, or all of the benefits of ownership without the inherent liabilities. Assets "HELD IN TRUST," are unaffected by bankruptcy, divorce, law suits, liens, levies or death.

A "Trust" is defined by Black's Law Dictionary as, "A RIGHT OF PROPERTY, REAL OR PERSONAL, HELD BY ONE PARTY FOR THE BENEFIT OF ANOTHER." The "Trustee(s)" HOLD the LEGAL AND EQUITABLE TITLE to the property for the benefit of the Beneficiaries/Capital Unit Holders. Although the trustees hold the property title, they do not own the property. The Trustee(s) is/are delegated the management authority for the Pure Trust Organization.

The Beneficiaries/Capital Unit Holders also do not own the property but they have the right to all of the benefits, proceeds and profits of it. This is called the "BENEFICIAL INTEREST." In a Sovereignty Pure Trust Organization the "BENEFICIAL INTEREST" is contractually NON-

ASSIGNABLE and for that reason a Creditor may not legally attach it. The Beneficiaries/Capital Unit Holders do not have any management control of the property.

A Pure Trust Organization is "CREATED" and given life, though a "CONTRACT IN THE FORM OF A PURE TRUST ORGANIZATION" which is referred to as the "INSTRUMENT." [Reproduced literally.]

Under the heading "A PURE TRUST ORGANIZATION HAS NO INCOME TAX REQUIREMENTS", the Sovereignty promotional materials stated in pertinent part:

Like Corporations, Revocable Living Trusts ARE statutory and are subject to legislative control and taxation. A Revocable Living Trust is required to file a 1041 Form each year. As confirmed by the Chief of Accounting for the IRS, * * * "A PURE TRUST ORGANIZATION HAS NO TAX REQUIREMENTS." Therefore, there is no legal requirement for a Pure Trust Organization to file a tax return.

* * * * *

A Pure Trust is not considered a taxable "Association" pursuant to tax law. Black's 6th Law Dictionary defines ASSOCIATION as follows: "What is designated as a trust or a partnership . . . may be classified as an association [only] IF it CLEARLY possesses [all] corporate attributes. Corporate attributes include:

centralized management, [2] continuity of existence, [3] free transferability of interests, [4] limited liability."

A Pure Trust Organization is not an "association" or an

"unincorporated association," because it does not possess the same attributes of a corporation, such as CONTINUITY OF EXISTENCE and FREE TRANSFERABILITY OF [BENEFICIAL] INTERESTS.

Further, unlike a corporation, a Pure Trust Organization is not an "artificial entity" nor does it owe its' existence to the charter power of the State.

A Pure Trust Organization is also not an alter ego or a NOMINEE for any trustee or beneficiary because no one individual holds legal and equitable title AND beneficial interest.

[Reproduced literally.]

Under the heading "IMPORTANT! PLEASE READ THE FOLLOWING BASIC RULES FOR STRUCTUTING [sic] A PURE TRUST ORGANIZATION BEFORE [EMPHASIZED FILLING OUT THE PURE TRUST ORGANIZATION APPLICATION", the Sovereignty promotional materials stated:

THE STRUCTURE OF THE TRUST IN GENERAL

Structuring a Pure Trust Organization is extremely simple if you just adhere to some basic rules. The Pure Trust Organization is like any other person or business entity that has the power to hold property, sell property, transfer property, conduct business, etc. It's simply an entity that has a different name and ID number than you. Property is transferred into the name of the Pure Trust as if it were any other person.

Once title to the property is in the name of the Trust Organization, it is protected by the ironclad Contractual and

Constitutional protections contained within the trust instrument (document). Because your right to contract cannot be impaired, you have PEACE OF MIND in knowing the property is safely protected. You will have the advantages of property ownership without the potential liabilities.

THE NUMBER OF PURE TRUSTS NEEDED FOR MAXIMUM ASSET PROTECTION

To maximize the benefits of the Pure Trust Organization, it is vital to put each asset that has THE POTENTIAL OF CREATING A LIABILITY into its own SEPARATE Trust Organization so that it does not jeopardize other assets. In a lawsuit, lien, levy, etc., the only assets that can be seized are those assets in which title is held in the name of the person or entity THAT CREATED THE LIABILITY. For example, let's say your car was involved in a serious accident that created a million dollars worth of damages and the insurance company refused to honor your claim. Because your name was on the Title to the car, if you are successfully sued, a judgement will be entered in YOUR NAME. Therefore, every asset held IN YOUR NAME would be subject to seizure. The advantage to a Pure Trust Organization is that it allows you to contractually move assets out of YOUR NAME while still retaining full control or all of the benefits of the property.

In the previous example, if you had the forethought to put the Title to the car, in the name of a Pure Trust Organization instead of your name, only the Pure Trust entity" [sic] could be sued, under its fictitious name. Other assets held in your name or in the names of other trusts would be immune from judgement!

If a court judgement, lien, or levy has been filed against

you, PERSONALLY, only those assets that you hold title to, IN YOUR OWN NAME are subject to seizure. Property can be transferred into a Pure Trust even AFTER it has been UNLAWFULLY liened or levied, in the absence of proper legal procedures and a lawful Court Hearing.

Businesses should always have a MINIMUM of two Pure Trust Organizations. The first operating entity should hold minimal assets, in case it is ever sued. Other Pure Trust Organizations should then be established under different names to hold and protect all other assets of the business organization. Business equipment that has the potential of creating a liability should always be segregated into separate trusts.

NAMING THE PURE TRUST ORGANIZATION:

Unless you are creating a Family Trust, do not use your last name or the word "Trust." Name your business as if it were a Sole Proprietorship. This will protect your privacy and will also make doing business and transferring property simpler.

THE TRUST IDENTIFICATION NUMBER:

Because a Pure Trust Organization has no tax requirements, it has no need for a Federal Employer Identification Number or a Social Security Number, which are necessary for tax reporting purposes only.

The Pure Trust Organization will be issued a nine-digit, internally generated, identification number for banking and identification purposes, UNRELATED TO TAXES. This Trust Identification Number is private and will not be linked to any Federal or State Government agency. It will be included on your final Pure Trust Organization Document(s). Each Trust will be

issued a separate number.

NAMING TRUSTEES AND BENEFICIARIES

The most important rule to remember when structuring your Trust Organization is that ONE INDIVIDUAL CANNOT BE BOTH A [emphasized] TRUSTEE AND A BENEFICIARY/CAPITAL UNIT HOLDER. It is the complete separation of these two entities that affords the Pure Trust Organization its protections. If the same person who holds the legal and equitable title, also has the beneficial interest or the right to proceeds, no trust has been created. The entity then is said to be operating as an "ALTER-EGO" [sic] or as a "NOMINEE" of the trust.

THE PROTECTOR:

The Protector has the power to terminate Trustees and/or appoint new Trustees. The Protector may also appoint "Successor Trustees" in the event a Trustee dies. A Protector cannot have any other position in the Pure Trust Organization. A Protector can be anyone, related or unrelated to you.

If you, as the original Exchanger (Settlor) are the only Trustee and a Successor Trustee has already been named, you do not need a Protector. A Protector eliminates a need to go to Court to change Trustees.

TRUSTEES

Trustees hold the legal and equitable title to the property in Trust, for the benefit of the Beneficiaries/Capital Unit Holders. They do not, however, actually OWN the property. A Trustee cannot also be a Beneficiary/Capital Unit holder.

Trustees have no rights to the "BENEFICIAL INTEREST" in the form of income and profits. However, they can receive a contractually agreed upon compensation in return for their Trustee services. Trustees have Management Control of the Pure Trust Organization. There can be one Trustee or as many Trustees as desired. All of the Trustees can work together in managing the Trust or any or all Trustee(s) can delegate management authority to one or more Managing Trustee(s) to transfer property, open and operate and bank accounts, and take care of the day to day operations.

ADVERSARIAL (UNRELATED) TRUSTEES

In order to maintain the tax immunity qualities of the Pure Trust Organization, it is important that it is not considered a "GRANTOR" TRUST, which is required to file a 1041 Form. According to the I.R.S.: "THE TITLE OF 'GRANTOR TRUST' ARISES WHEN THERE IS NO TRUSTEE WITH AVERSE INTEREST." The words "adverse" or "adversarial" mean UNRELATED. The rule of structure is that; "the MAJORITY of trustees must have an interest 'ADVERSE' or UNRELATED to that of the beneficiaries/capital unit holders. This means that if the beneficiaries are your wife/ husband/ children, the MAJORITY of trustees cannot be related to them. Therefore, for example, if you were a man and wanted to be a trustee and make your wife and children beneficiaries, you must also have at least two other unrelated Trustees.

If you and your wife both want to be trustees, there must also be at least THREE other unrelated Trustees. Our company can provide adversarial (unrelated) trustees for you at a minimal cost. These trustees will delegate the authority to your Managing Trustee to open the bank account, sign checks, transfer property, sign the minutes and make management

decisions concerning the contract of trust. If you are not related to the beneficiary(ies) you do NOT need adversarial trustees.

THE GENERAL MANAGER

Although it is typically the Trustees or Managing Trustee(s) that will be responsible for the management of theTrust, a General Manager may also be appointed for that purpose. The General Manager is merely an employee of the Pure Trust and is not an integral part of it. However, some individuals choose this position because they want to manage the Trust with privacy. When transferring title to real property and automobiles, it is necessary in include the name(s) of the Trustee(s) in addition to the name of the Pure Trust, as a matter of public record. The General Manager's name, however, would not appear on title. It would only be included within the trust minutes, which are totally private.

THE BENEFICIARY/CAPITAL UNIT HOLDERS

Beneficiaries/Capital Unit Holders have the right to the "BENEFICIAL INTEREST" which is a right to the income, profits, and proceeds and use of the Pure Trust Organization. However, in order to provide maximum asset protection, the trust must be "Pure." That means that "BENEFICIARIES/CAPITAL UNIT HOLDERS" CANNOT have any management control of the Pure Trust Organization. The Trustee assigns the "Exchanger" (Settlor) 100 CAPITAL UNITS, which represent 100% of the beneficial interest of the Pure Trust, in exchange for the property he or she conveys into the trust. The Exchanger can then either keep all 100 Certificates or divide them in any manner among Beneficiaries of his or her choice.

BANK ACCOUNTS

Sovereignty Pure Trusts can also open a completely private bank account with no Federal ID Number or Social Security number at a major bank. This account will be like any other checking account, except that it is completely private. The cost for this is $ 125 per account. [Reproduced literally.]

The Sovereignty promotional materials included copies of two letters. The first was a letter dated March 29, 1996, written by "Gregory P. Karl, CPA", and addressed to "Chuck Felthaus, Chief- Accounting Branch, Internal Revenue Service" in Philadelphia, Pennsylvania (Karl letter). The second was a letter dated December 17, 1996, written by "Charles F. Felthaus, Chief, Accounting Branch", and addressed to "Gregory Paul Karl" (Felthaus letter). The Karl letter stated in pertinent part:

I have a number of Pure Trust clients and I have an urgent request. Please let me know the income tax requirements for a Pure Trust Organization as well as the proper procedure for obtaining an Internal Revenue Service issued Employer Identification Number for them.

The Felthaus letter stated in pertinent part: "We cannot process your application for a [sic] Employer Identification Number. A Pure Trust organization has no tax requirements, therefore a [sic] Employer Identification Number is not required."

The Sovereignty promotional materials also included a document entitled "Pure Trust Organization Application" (application). The application requested certain information, including the "settlor's" n22 name and address, the name of the pure trust organization, the names of the trustees, whether each trustee was to have signatory authority over any bank accounts,

the names of the beneficiaries, and the number of so-called capital units each beneficiary was to receive.

----------Footnotes----------

n22 The application stated: "The Settlor(s) is/are the individual(s) who will be transferring property into the 'Trust Estate'".

----------End Footnotes----------

DEALINGS WITH THE STATE OF INDIANA

FILINGS WITH THE KNOX COUNTY RECORDER'S OFFICE

DOCUMENTS RELATING TO SANDBAR WHOLESALE TRUST AND SANDBAR REAL ESTATE TRUST

On October 12, 1995, two documents, each of which consisted of three pages of printed forms (collectively, the two three-page documents), were filed with the Knox County Recorder's Office. n23 The first page of each of those documents, which was numbered "Page 1", was a cover page (cover page) on which appeared the heading "Common Law Contract and Declaration IN THE FORM OF A Private Pure Living Family Trust and Private Retirement Plan" and a mailing address for Sovereignty in Las Vegas, Nevada. Each page of each of the two three-page documents (each three-page document) contained identical language, except that one document made references to Sandbar Wholesale Trust and the number 52-9876145 and the other document made references to Sandbar Real Estate Trust and the number 52-9876125.

----------Footnotes----------

n23 The record does not disclose who filed those documents with the Knox County Recorder's Office.

----------End Footnotes----------

At the bottom of the cover page of each three-page document appeared the language "Common Law Copyright, Sovereignty Pure Trusts" and at the bottom of the second page of each three-page document appeared the language "Common Law Copyright, 1994 Sovereignty Pure Trusts, All Rights Reserved". No such language appeared at the bottom of the third page of each three-page document.

The second page of each three-page document, which was numbered "Page 24", stated:

BY ALL THOSE PRESENT, for the purposes of protecting, conserving and enlarging the corpus of this "Trust Estate," for the benefit of the heirs of the Exchanger(s) and other holders of capital unit certificates, and for the establishment of a Private Retirement Plan to assure that such Certificate Holders may look forward, with anticipation, to a retirement with financial security and dignity, and without fear that this period of life will be lacking in the necessities to sustain them as human beings within our society, and for other purposes contained herein, the parties named herein, hereby establish this unimpairable Contract and Declaration in the form of a Common Law, Constitutional, Irrevocable, Sovereign Private Express, Pure Trust, Contractual Organization and Private Retirement Plan.

* * * * *

IN WITNESS THEREOF, the Creator appoints and

Trustee(s) have agreed to the terms, stipulations and covenants stated herein and, hereby, acknowledged the conveyance, delivery and acceptance of certain real and/or personal property listed in Schedule A and Addendum to be held in Trust according to the terms, herein. [Reproduced literally.]

Neither of the two three-page documents disclosed the identities of the "Exchangers" and the "Certificate Holders" that were referred to on the second page of each such document. Nor did either of those documents include the "Schedule A" and the "Addendum" that also were referred to on that page. (We shall refer to the language appearing on the second page of each three-page document as the declaration.)

The declaration appearing on the second page of each three-page document was signed in the name of Lynne Meredith, who was identified as "Sovereignty Pure Trusts, Creator", and in the names of James Rabold, Susan Thomas Barmes, and Jennifer Burgess, n24 all three of whom were identified as trustees. Petitioner Barbara Barmes (Ms. Barmes), in her capacity as **[*52]** a notary public, indicated on the second page of each three-page document that James Rabold, Susan Thomas Barmes, and Jennifer Burgess signed the declaration appearing on each such page.

----------Footnotes----------

n24 On Feb. 5, 1996, Jennifer Burgess was divorced from Mark Barmes. On Mar. 12, 1996, she resigned her duties as trustee of both trusts. On Feb. 12, 1999, Susan Thomas Barmes resigned her duties as trustee of both trusts. On May 15, 1999, James Rabold resigned his duties as trustee of both trusts. Beginning on Mar. 27, 1996, certain Community Bank records identified Kim Hall Barmes as a trustee of both trusts.

----------End Footnotes----------

The third page of each three-page document, which was unnumbered, was entitled "MINUTES OF THE PROCEEDINGS OF THE TRUSTEES". One such third page referenced Sandbar Wholesale Trust and the other referenced Sandbar Real Estate Trust. n25 (We shall refer to the third page of each three-page document as minutes.) The minutes stated, inter alia:

----------Footnotes----------

n25 The third page of the document referencing Sandbar Real Estate Trust was entitled "MINUTES OF THE PROCEEDINGS OF THE TRUSTEES OF; [sic] Sandbar Family Trust". We believe that that reference to Sandbar Family Trust was a typographical error, and we construe such minutes to be minutes relating to Sandbar Real Estate Trust. That is because all other references in such minutes were to the Sandbar Real Estate Trust.

----------End Footnotes----------

Marvin L. Barmes and Barbara J. Barmes is/are hereby appointed as General Manager(s), and Managing Agent(s), agreeing to act at all times in the best interest of the Company and its Capital Unit Certificate Holders and is/are, hereby, approved to open a bank account for * * * [Sandbar Wholesale Trust or Sandbar Real Estate Trust] and to be signer(s) on such account.

General Manager(s), shall accept the same duties and responsibilities as set forth for the Trustees of this Organization.

General Manager(s) shall hold no Title, legal or equitable, and no right to the Capital Unit interest, income or profit distributions of this "Trust Estate". Further, General Manager(s) shall not be liable for any of the debts of this "Trust Estate".

A separate Contract will be executed, setting forth compensation.

The undersigned hereby certifies that the above has been duly adopted by the Board of Trustees and direct that the minutes of these proceedings be recorded in and become a part of the official Company Minute Book.

The respective minutes for the trusts were signed in the names of James Rabold and Jennifer Burgess. Susan Thomas Barmes witnessed those signatures in her capacity as a notary public.

At all relevant times, the State of Indiana had no records of any business trust under any of the following names: Sandbar Wholesale Trust, Sand Bar Wholesale Trust, Sandbar Real Estate Trust, or Sand Bar Real Estate Trust.

WARRANTY DEEDS

On October 18, 1995, three separate warranty deeds (deeds) executed on that date by petitioners were recorded with the Knox County Recorder's Office. n26 Those deeds pertained to the Fritchton property, petitioners' business location at 114 Main Street, and petitioners' business location at 120 Main Street, respectively (collectively, the three parcels of real estate). At the bottom of each of the three deeds, the following handwritten statement appeared: "This instrument prepared by Marvin L. Barmes." Each deed contained a mailing address for Sandbar Real Estate Trust at 120 Main Street, Vincennes, Indiana, and the following language:

----------Footnotes----------

n26 The record does not disclose who submitted the deeds for recording with the Knox County Recorder's Office.

----------End Footnotes----------

KNOW ALL MEN BE [sic] THESE PRESENTS:

That I (we), Marvin L. Barmes and Barbara J. Barmes the undersigned grantor(s), for the consideration of Ten Dollars, and other valuable considerations, do hereby convey to Sandbar Real Estate Trust all rightm [sic] title and interest to and in the certain parcel of Real Property situated in Knox County, State of Indiana * * *

Although each deed stated nominal consideration for the conveyance described therein, petitioners did not receive any consideration for such conveyances. After those conveyances were made, petitioners continued to enjoy the use of the three parcels of real estate.

FILING WITH THE ASSESSOR OF THE TOWNSHIP OF VINCENNES, INDIANA

On March 14, 1996, Mr. Barmes signed, under penalties of perjury, State of Indiana Form 103 -- Long Form, Business Tangible Personal Property Assessment Return (Indiana business tangible personal property assessment return). In that return, Mr. Barmes reported the name of the taxpayer as Sandbar Wholesale Trust and the Federal identification number belonging to that taxpayer as 52-9876145. Mr. Barmes reported in the Indiana business tangible personal property assessment return that the taxpayer's Federal income tax year ended on

December 31, 1995, and that the name under which Federal income taxes were filed was Sandbar Wholesale Trust. In that return, Mr. Barmes also reported that the names under which the businesses were conducted were Barbara's Gift Shop and Barmes Wholesale and that the businesses were not conducted in the form of a trust but were conducted in the form of what Mr. Barmes described as an "Unincorporated Business Organization". Mr. Barmes further reported in the Indiana business tangible personal property assessment return that the business properties were located at "12

UNEMPLOYMENT COMPENSATION CLAIMS WITH RESPECT TO BARBARA'S GIFT SHOP AND BARMES WHOLESALE

At all relevant times, the State of Indiana Department of Workforce Development (Department of Workforce Development) administered claims for unemployment insurance benefits and required employers to file quarterly reports and make payments with respect to such claims. At those times, as part of its administration of such claims, the Department of Workforce Development established and maintained a separate account for each employer who had employees working in the State of Indiana, including an account for Barbara's Gift Shop. The Department of Workforce Development maintained such an account for Barbara's Gift Shop at all relevant times, at least through the year 1997. Prior to January 1, 1996, Barbara's Gift Shop timely filed quarterly reports with the Department of Workforce Development and maintained its employer account in good standing (i.e., made payments into that account). During the two-year period 1996 through 1997, the Department of Workforce Development continued to maintain an employer account for Barbara's Gift Shop; however, Barbara's Gift Shop did not timely file quarterly reports or make any payments into

its employer account.

Beginning no later than January 10, 1997, the Department of Workforce Development maintained an employer account for Sandbar Wholesale Trust. The Department of Workforce Development established that account and assigned the number 413446 to that account on a date not disclosed by the record after having received a certain number of claims for unemployment benefits from individuals who claimed (e.g., by presenting canceled checks) that they had received wages from an entity using the name Sandbar Wholesale Trust. In order to establish an employer account for Sandbar Wholesale Trust, the Department of Workforce Development requested certain information and documentation from petitioners on a date not disclosed by the record. However, the Department of Workforce Development did not receive any response from petitioners with respect to the information and documentation requested.

On January 3, 1997, n27 Jill Beamon (Ms. Beamon) made a claim for unemployment benefits with the State of Indiana Department of Employment and Training Services (Department of Employment and Training Services). n28 On January 7, 1997, in connection with Ms. Beamon's claim, a claims deputy with the Department of Employment and Training Services (claims deputy) completed a form entitled "REQUEST FOR INSPECTION AND WAGE INFORMATION" (request for inspection and wage information form), which Ms. Beamon had signed on January 3, 1997 n29 (Ms. Beamon's request for inspection and wage information form). Sandbar Wholesale Trust was identified as the employer on that form.

----------Footnotes----------

n27 The date Jan. 3, 1996, appeared on the form that Jill Beamon, who worked at Barmes Wholesale from November

1994 to Dec. 23, 1996, signed when she made her claim for unemployment benefits with the Ind. Department of Employment and Training Services. However, it is clear from the record that that form was actually signed on Jan. 3, 1997, and that the year 1996 was written on that form by mistake.

n28 At all relevant times, the Department of Workforce Development was comprised of four entities, which included the Department of Employment and Training Services. See Ind. Code Ann. sec. 22-4.1-2-2 (Michie 1997). The Department of Employment and Training Services included an unemployment insurance board and an unemployment insurance review board. See id. at sec. 22-4.1-2-2(1).

n29 The date Jan. 3, 1996, appeared on the request for inspection and wage information form that Ms. Beamon signed. However, it is clear from the record that that form was actually signed on Jan. 3, 1997, and that the year 1996 was written on that form by mistake. See supra note 27.

----------End Footnotes----------

At all relevant times, the Department of Employment and Training Services used the request for inspection and wage information form whenever (1) an individual made a claim for unemployment benefits, and (2) the Department of Employment and Training Services did not have a record of wages having been paid by the individual's employer. After having completed the request for inspection and wage information form, the claims deputy sent that form to an audit examiner with the Department of Employment and Training Services (audit examiner) in order to conduct an investigation of the claim. After having conducted an investigation, the audit examiner reported the results of the investigation in the request for inspection and wage information form.

On January 10, 1997, an audit examiner who had conducted an investigation with respect to an entity using the name Sandbar Wholesale Trust reported the results of that investigation n30 in Ms. Beamon's request for inspection and wage information form. That investigation revealed that an account had been established with the Department of Workforce Development for Sandbar Wholesale Trust, but that that entity had not reported to the Department of Workforce Development any wages paid by it during the first three quarters of 1996. The audit examiner indicated in Ms. Beamon's request for inspection and wage information form that, although he had made contact with the entity identified as Sandbar Wholesale Trust, he received no response or cooperation from that entity. n31

----------Footnotes----------

n30 That investigation occurred on a date not disclosed by the record between Jan. 3 and 10, 1997.

n31 Ms. Beamon's request for inspection and wage information form contained at least three different sets of handwriting, one that belonged to Ms. Beamon, one that belonged to the claims deputy responsible for completing that form, and one that belonged to the audit examiner responsible for conducting the investigation with respect to Ms. Beamon's claim. It is clear from our examination of Ms. Beamon's request for inspection and wage information form that the audit examiner changed the information that was originally reported in that form as the "Employer" and "Account Number". The audit examiner identified "Sandbar Wholesale Trust, Barbara's Gift Shop" as the "Employer" and listed 413446 as the "Account Number" in that form. Account number 413446 was the account number assigned by the Department of Workforce

Development to Sandbar Wholesale Trust. We are unable to determine from Ms. Beamon's request for inspection and wage information form who was originally identified in that form as the "Employer" and what number was originally listed in that form as the "Account Number".

----------End Footnotes----------

On January 28, 1997, the Department of Workforce Development issued a notice (January 28, 1997 notice) addressed to "Sandbar Wholesale Trust, Barbara's Gift Shop, 120 Main Street, Vincennes, IN 47591". That notice showed the number (account number 413446) that the Department of Workforce Development had assigned to the account that it maintained for Sandbar Wholesale Trust. The January 28, 1997 notice indicated that Ms. Beamon had made a claim for unemployment compensation and that there was a potential liability for unemployment insurance benefit charges as a result of that claim.

On February 3, 1997, Mr. Barmes wrote the following statement, which he signed as general manager, on the bottom of a copy of the January 28, 1997 notice: "Sandbar Wholesale Trust did not open an account with Indiana Department of Workforce Development. Sandbar Wholesale Trust does not now [have] or ever have [sic] had employees".

On March 3, 1997, the Department of Workforce Development issued another notice (March 3, 1997 notice) addressed to "Sandbar Wholesale Trust, Barbara's Gift Shop, 120 Main Street, Vincennes, IN 47591". That notice showed the same Department of Workforce Development employer account number for Sandbar Wholesale Trust as shown on the January 28, 1997 notice. The March 3, 1997 notice indicated that Ms. Beamon had made a claim for unemployment

compensation and that there was a potential liability for unemployment insurance benefit charges as a result of that claim.

At the bottom of a copy of the March 3, 1997 notice, on March 6, 1997, Susan Thomas Barmes signed the following typed statement as trustee and "without prejudice": "Sandbar Wholesale Trust did not open this account and has paid no money into this account. J A Beamon was an independent contractor starting October 13, 1995 until December 23, 1996."

On May 7, 1997, the Department of Workforce Development issued a notice to Sandbar Wholesale Trust entitled "Notice of Complete Disposition of Business to Acquirer" (May 7, 1997 notice). That notice stated:

YOU [SANDBAR WHOLESALE TRUST] BECAME THE SUCCESSOR EMPLOYER TO THE NAMED DISPOSER [MARVIN L. & BARBARA J. BARMES] UNDER THE PROVISIONS OF THE INDIANA CODE 22-4-9-3. IN ACCORDANCE WITH THE PROVISIONS OF THE ACT, YOUR ACCOUNT ASSUMED THE EMPLOYMENT EXPERIENCE OF YOUR PREDECESSOR. YOUR CONTRIBUTION RATE FOR THE YEAR OF ACQUISITION IS 1.1000%. YOUR CONTRIBUTION RATE FOR THE CURRENT YEAR IS 5.5000%.

IF YOU DISAGREE WITH THE DETERMINATION, YOU MAY FILE A FORMAL WRITTEN PROTEST WITHIN FIFTEEN (15) DAYS FROM THE DATE OF THIS NOTICE. PLEASE USE YOUR NEW ACCOUNT NUMBER 413446 ON ALL FUTURE CORRESPONDENCE. ADDITIONAL INFORMATION REGARDING YOUR RESPONSIBILITIES IS BEING SENT UNDER SEPARATE COVER.

OUR RECORDS SHOW YOU ACQUIRED 100% OF THE BUSINESS ON 10/12/95 FROM DISPOSER: 138071.

In response to the May 7, 1997 notice, on May 11, 1997, petitioners executed a document entitled "AFFIDAVIT" and "FORMAL WRITTEN PROTEST" (protest affidavit). In the protest affidavit, petitioners stated:

> Sandbar Wholesale Trust that acquired dba Barmes Wholesale/dba Barbara's Gift Shop did not become the successors of the employees. They were all terminated prior to the business transfers. Marvin L. & Barbara J. Barmes let their employees go before the transfer of the business and they were not passed onto Sandbar Wholesale Trust.
>
> Sandbar Wholesale Trust managers took over and told the former employees of Marvin L. & Barbara J. Barmes they could be contracted by Sandbar Wholesale Trust and would have to fill out new paperwork, which included; Work for Hire Statement, U.S. Department of Justice Immigration and Naturalization Service Form I-9, Late/Absenteeism Policy, Affidavit of Citizenship and Domicile, Access to Trade Secrets and Confidential Information and Form W-8. * * * No Form W-4 filled out.
>
> Upon the completion of the above paperwork they would be Independent Contractors for Sandbar Wholesale Trust.
>
> Enclosed you will find two letters. One from Gregory Paul Karl, CPA to Internal Revenue Service. The other from Internal Revenue Service, Chief Accounting Branch, Charles F. Felthaus to Gregory P. Karl, CPA. Sandbar Wholesale Trust is a Pure Trust. A Pure Trust organization has no tax requirements, therefore an Employer Identification Number is not required.

[Reproduced literally.]

The two letters to which petitioners referred in the protest affidavit were copies of the Karl letter and the Felthaus letter that Sovereignty included in its promotional materials and provided to petitioners.

FEDERAL EMPLOYMENT TAX RETURNS

FEDERAL EMPLOYMENT TAX RETURNS -- PETITIONERS

On July 7, 1995, Ms. Barmes signed Form 941, Employer's Quarterly Federal Tax Return (Form 941), for the quarter ended June 30, 1995, which was filed under the name "Marvin L. and Barbara J. Barmes PTR", EIN 35-1305131. That form reflected total wages, tips, and other compensation paid by Marvin L. and Barbara J. Barmes PTR in the amount of $ 304,990.23.

On October 5, 1995, Ms. Barmes signed Form 941 for the quarter ended September 30, 1995, which was filed under the name "Marvin L. and Barbara J. Barmes PTR". That form reflected total wages, tips, and other compensation paid by Marvin L. and Barbara J. Barmes PTR in the amount of $ 325,414.97.

On January 16, 1996, Ms. Barmes signed Form 941 for the quarter ended December 31, 1995, which was filed under the name "Marvin L. and Barbara J. Barmes PTR", EIN 35-1305131. That form reflected total wages, tips, and other compensation paid by Marvin L. Barmes and Barbara J. Barmes PTR in the amount of $ 92,179.53.

On March 11, 1997, Mr. Barmes signed Form 941 for the quarter ended March 31, 1997, which was filed under the name "Marvin L. and Barbara J. Barmes PTR", EIN 35-1305131. In that form, Mr. Barmes wrote "Nothing to report", checked the box indicating that Marvin L. and Barbara J. Barmes PTR did

not have to file returns in the future, and stated that the date on which final wages were paid by Marvin L. and Barbara J. Barmes PTR was October 12, 1995.

FEDERAL EMPLOYMENT TAX RETURNS -- SANDBAR WHOLESALE TRUST AND SANDBAR REAL ESTATE TRUST

As of the date of the trial in this case, neither Sandbar Wholesale Trust nor Sandbar Real Estate Trust had filed a Federal employment tax return or paid any Federal employment tax.

FEDERAL INCOME TAX RETURNS

PETITIONERS' 1994 FEDERAL INCOME TAX RETURN

Petitioners filed Form 1040, U.S. Individual Income Tax Return for 1994 (petitioners' 1994 joint return), which they signed on March 10, 1995. In that return, petitioners reported taxable income of $ 837,210. Such taxable income did not include any wages or salaries.

Petitioners' 1994 joint return included Schedule C, Profit or Loss From Business (1994 Schedule C). The 1994 Schedule C requested, and petitioners provided, inter alia, the following information:

Information Requested	Information Provided
Name of proprietor	Marvin L. Barmes
Principal business or profession, including product or service	Retail and wholesale, general merchandise
Business name	Barbara's Gift Shop and

Barmes Wholesale

Employer identification number (EIN)	35-1305131
Business address	120 Main St, Vincennes, IN 47591
Accounting method	Accrual
Method used to value closing inventory	Cost
Gross receipts or sales (gross receipts)	$ 5,445,178
Returns and allowances	370
Cost of goods sold	2,820,049
Gross profit	2,624,759
Other income	106,567
Gross income	2,731,326
Total expenses	1,871,671
Expenses for business use of your home	0
Net profit or (loss)	859,655
Inventory at beginning of year	411,442
Purchases less cost of items withdrawn for personal use	2,850,804
Cost of labor	0
Materials and supplies	0
Inventory at end of year	442,197

The percentage of gross profit reported in the 1994 Schedule C to gross receipts reported in that schedule was 48.2 percent.

Included in the total expenses reported in petitioners' 1994 Schedule C was automobile depreciation in the amount of $ 5,920 for a Cadillac and a Corvette (petitioners' two automobiles). Petitioners purchased both of those automobiles in 1994, the Cadillac for $ 39,215 and the Corvette for $ 30,090. Attached to petitioners' 1994 joint return was Form 4562, Depreciation and Amortization (Including Information on Listed Property) (Form 4562). In Part V, Listed Property --

Automobiles (Part V), Section B -- Information on Use of Vehicles (Section B) of that form, petitioners claimed total miles and total business miles of 3,500 with respect to the Cadillac and 3,200 with respect to the Corvette. In Part V, Section A -- Depreciation and Other Information (Section A) of that form, petitioners indicated that they had written evidence to support the claimed business use of petitioners' two automobiles.

PETITIONERS' 1995 FEDERAL INCOME TAX RETURN

Petitioners filed Form 1040, U.S. Individual Income Tax Return for 1995 (petitioners' 1995 joint return), which they signed on April 3, 1996, "Without Prejudice". In that return, petitioners reported no wages or salaries and no tax due.

Petitioners' 1995 joint return included Schedule C (1995 Schedule C). In the 1995 Schedule C, petitioners reported the same information with respect to the name of the proprietor, principal business, business name and address, EIN, accounting method, and method used to value closing inventory as they had reported in the 1994 Schedule C. In addition, the 1995 Schedule C requested, and petitioners provided, inter alia, the following information:

Information Requested	Information Provided
Gross receipts	$ 4,217,062
Returns and allowances	16
Cost of goods sold	2,340,822
Gross profit	1,876,224
Other income	--
Gross income	1,876,224
Total expenses	1,973,107

Expenses for business use of your home	--
Net profit or (loss)	(96,883)
Inventory at beginning of year	442,197
Purchases less cost of items withdrawn for personal use	1,898,625
Cost of labor	--
Materials and supplies	--
Inventory at end of year	0

Included in the total expenses reported in the 1995 Schedule C was automobile depreciation in the amount of $ 9,400 for petitioners' two automobiles. Attached to petitioners' 1995 joint return was Form 4562. In Part V, Section B of that form, petitioners claimed total miles and total business miles of 5,000 with respect to the Cadillac and 3,000 with respect to the Corvette. In Part V, Section A of that form, petitioners indicated that they had written evidence to support the claimed business use of petitioners' two automobiles.

As of the date of the trial in this case, petitioners had not filed Federal income tax returns for tax years after 1995.

FEDERAL INCOME TAX RETURNS -- SANDBAR WHOLESALE TRUST AND SANDBAR REAL ESTATE TRUST

As of the date of the trial in this case, neither Sandbar Wholesale Trust nor Sandbar Real Estate Trust had filed a Federal income tax return or paid any Federal income tax.

RESPONDENT'S EXAMINATION OF PETITIONERS' 1994 AND 1995 JOINT RETURNS

On April 30, 1996, respondent's revenue agent Jon Eric Powell (revenue agent Powell) made initial contact with petitioners via the telephone with respect to respondent's

examination of petitioners' 1994 joint return. Shortly thereafter, revenue agent Powell sent petitioners a letter (examination letter) formally notifying petitioners that their 1994 joint return was under examination. In response to the examination letter, on a date after April 30, 1996, that is not disclosed by the record, petitioners indicated to revenue agent Powell that they did not have to provide him with any records with respect to respondent's examination of their 1994 joint return. Consequently, on a date before May 30, 1996, that is not disclosed by the record, revenue agent Powell issued a summons (summons) to petitioners, which required them to appear before him on May 30, 1996, and to produce certain records with respect to respondent's examination of petitioners' 1994 joint return.

On May 30, 1996, in response to the summons, petitioners met with revenue agent Powell (May 30, 1996 meeting). During that meeting, revenue agent Powell questioned petitioners about the information requested in the summons with respect to petitioners' 1994 joint return, and petitioners responded that they were not required under the Fourth and Fifth Amendments to provide such information to respondent. Consequently, revenue agent Powell ended the May 30, 1996 meeting.

During the course of the examination of petitioners' 1994 joint return, on a date after April 30, 1996, and before May 20, 1996, that is not disclosed by the record, revenue agent Powell received a report (CID report) from the Criminal Investigation Division (CID) of the Internal Revenue Service (IRS). The CID report indicated that Barbara's Gift Shop had failed to file certain Federal employment tax (employment tax) returns and had, in the opinion of the CID, arbitrarily changed the classification of its workers from employees to independent contractors. Revenue agent Powell became aware from reading the CID report that Sandbar Wholesale Trust was formed

sometime during October 1995. On May 20, 1996, revenue agent Powell forwarded the CID report to respondent's revenue officer Shawn Kennedy (revenue officer Kennedy) for further investigation of the employment tax issues contained therein.

During the course of the examination of petitioners' 1994 joint return, on a date after May 30, 1996, and before November 6, 1996, that is not disclosed by the record, revenue agent Powell received petitioners' 1995 joint return from the Internal Revenue Service Center in Cincinnati, Ohio. Revenue agent Powell reviewed that return and compared it with petitioners' 1994 joint return. That comparison disclosed to revenue agent Powell that in the 1995 joint return there were: (1) A significant decrease from 1994 to 1995 in the gross receipts that petitioners reported in the respective Schedules C of petitioners' 1994 joint return and 1995 joint return, (2) an ending inventory for Barbara's Gift Shop for 1994 of $ 442,197 and an ending inventory for that business for 1995 of $ 0, and (3) an increase from 1994 to 1995 in the expenses that petitioners claimed in the respective Schedules C of petitioners' 1994 joint return and 1995 joint return. As a result, revenue agent Powell formally commenced an examination of petitioners' 1995 joint return.

Although revenue agent Powell became aware through the CID report of certain employment tax issues involving Barbara's Gift Shop and Sandbar Wholesale Trust, he concluded that that information did not affect his examination of petitioners' 1994 and 1995 joint returns, and he did not make any inquiries of petitioners regarding Sandbar Wholesale Trust during his examination of those joint returns. Nor did petitioners allude to Sandbar Wholesale Trust or to any purported transfer of the two businesses to that trust during that examination.

On November 6, 1996, revenue agent Powell had a telephone conversation with Mr. Barmes during which he

advised Mr. Barmes that he had completed an examination report with respect to petitioners' 1994 and 1995 joint returns (examination report) that contained certain adjustments which he had made to those returns. During that telephone conversation, revenue agent Powell asked Mr. Barmes whether Mr. Barmes intended to provide any information or documentation to the IRS to refute those adjustments. At no time did Mr. Barmes provide any information or documentation to the IRS to refute or otherwise respond to the adjustments contained in the examination report.

On November 16, 1996, each petitioner executed an affidavit, both of which respondent received on November 20, 1996. Each of those affidavits stated in pertinent part:

1. *I am a "natural born free Citizen" adult Constitutionally, aka USA National, of Indiana Republic by birth, thus of America, and a temporary inhabitant living in Knox County, Indiana Republic; thankfully endowed by our Creator God with Unalienable Rights partially enumerated in America's founding organic documents, which I have never with knowingly intelligent acts waived * * *

2. Recent diligent studies have convinced me of the above, and that as such I am not "subject to" the territorially-limited "exclusive Legislation" and its foreign jurisdiction mandated for Washington, D. C. etc. * * *, including its "internal" government organizations therein or by contract adhesioned thereto across America. And neither are millions of other such Citizens, unless they have provided "WAIVERS of Constitutional Rights" with "knowingly intelligent act" (contracts with such government[s]) "with sufficient awareness of the relevant circumstances and likely consequences"; as ruled by the 1970 U.S. supreme Court (*Brady v. US, 397 U.S. 742 at*

748, 25 L. Ed. 2d 747, 90 S. Ct. 1463). I've given no such "waivers".

3. These studies also prove that a shrewd and criminal Constructive Fraud has been slipped over the "UNITED STATES OF AMERICA" by a corporate federal #2 -- "UNITED STATES" and accomplices under counterfeit "color of law" * * *. By never-repealed American Law, such sources of past and present Criminal Element in (and behind) Government, hereinafter referred to as the "CEG", should be brought to Justice in a Constitutional Court for aiding and abetting this Fraud as willing Accomplices. It is for such Court with a 12-member Jury of Peers to decide who is and isn't Guilty among personnel of government, media, schools, lawyers, accountants, clergy and other pushers of misinformation mind-set propaganda in this and related regards, thank God.

4. Due to such shrewd entrapments, over the years I unwittingly signed many of the related documents or contracts, some even under the foreign "perjury" jurat as was supposedly required. With American Law On this Citizen's side, I hereby REVOKE all such signatures and render them null and void except for those that I choose to have measured as being under "TDC" (threat, duress and/or coercion), past and now. This is also my Lawful Notice that all such signatures of mine in the future, with such governmental or otherwise-adhesioned sources, are to be considered as under "TDC", whether appearing therewith or otherwise and including banks etc.* * *

5. With this accurate knowledge, I Lawfully "squarely challenge" the fraudulent usurping-octopuslike JURISDICTION/AUTHORITY cited in item #2 that does NOT apply to me * * *. * * * For fairness, IRS agents generally lack

Lawful "Delegation of Authority", and their so-called "Form 1040" seems to be bogus concerning me.

6. With all of the above in mind, it appears that this private Citizen is by Law as "Foreign" and a " Non-Resident Alien"***.

On December 10, 1996, petitioners jointly executed a declaration in which they stated the following:

I, Marvin L. Barmes/Barbara J. Barmes, hereby declare that I do not have nor have I had any income from Alcohol, Tobacco and Firearms. I also declare that I do not have nor have I had a contract with the Department of the Treasury to manufacture, sell, or distribute alcohol, tobacco, or firearms. All gasoline used is and was purchased at a gasoline service station.

I am not a federal employee.

I am not a corporation or partnership.

I am not effectively connected with the conduct of a trade or business within the United States.

I was not involved in any revenue taxable activity.

I declare under penalty of perjury UNDER THE LAWS OF THE UNITED [sic] STATES OF AMERICA that the foregoing to the best of my knowledge and belief is true and correct.

RESPONDENT'S COMMUNICATIONS WITH PETITIONERS WITH RESPECT TO SANDBAR WHOLESALE TRUST AND SANDBAR REAL ESTATE TRUST

On May 1, 1997, respondent's revenue agent Rosetta Arnold

(revenue agent Arnold) issued two letters (revenue agent Arnold's two letters dated May 1, 1997), one of which was addressed to "Sandbar Real Estate Trust, Attn: Marvin and Barbara Barmes, Managing Agents" and the other of which was addressed to "Sandbar Wholesale Trust, Attn: Marvin and Barbara Barmes, Managing Agents". Revenue agent Arnold's two letters dated May 1, 1997, were identical in content, except that one letter referenced Sandbar Real Estate Trust and the other letter referenced Sandbar Wholesale Trust. In those two letters, revenue agent Arnold stated that respondent had no record of receiving Form 1041, U.S. Fiduciary Income Tax Return (Form 1041), for either of the two trusts for the tax periods ended 1995 and 1996. Revenue agent Arnold further stated in those two letters:

If you are required to file the returns, but have not done so, we are requesting these returns to be filed by May 16, 1997. Please submit the following information by May 16, 1997 ***.

- Completed returns

- A copy of the managing agent's compensation agreement referenced in the trust agreement

- A copy of Schedule A and the Addendum referred to in the trust document

* * * * * * *

If you were not required to file returns for the periods indicated, please explain why you are not [sic] longer liable in the space provided below.

On May 8, 1997, Mr. Barmes responded to revenue agent

Arnold's two letters dated May 1, 1997. Mr. Barmes made identical responses in the space provided on the second page of each of revenue agent Arnold's two letters dated May 1, 1997. That response consisted of the following statement: "No beneficiary disbursements made. No K- 1's necessary."

On May 14, 1997, revenue agent Arnold issued a letter addressed to "Marvin and Barbara Barmes, Managing Agents" (revenue agent Arnold's letter dated May 14, 1997). That letter stated in pertinent part:

We have received your response on May 9, 1997 to our May 1, 1997 letters requesting the tax returns (1041) for Sandbar Wholesale Trust and Sandbar Real Estate Trust for the tax years of 1995 and 1996. Based on your response, it appears that these two entities are required to file income tax return [sic] per *Internal Revenue Code Section 6012(a)(4)*. However, we have no records of receiving these tax returns.

If you have filed these returns please provide us a copy by May 21, 1997. If you have not filed these returns, we are requesting these returns be filed by May 28, 1997. * * * The following information should be submitted to the address listed above by May 28, 1997:

- Completed returns

- A copy of the managing agent's compensation agreement referenced in the trust agreement

- A copy of Schedule A and the Addendum referred to in the trust document.

On May 16, 1997, Mr. Barmes responded in writing (Mr. Barmes' letter dated May 16, 1997) to revenue agent Arnold's

letter dated May 14, 1997. Mr. Barmes' letter dated May 16, 1997, stated in pertinent part: "According to our CPA, Gregory P. Karl out in California our Pure Trust organization has no tax requirements according to the Internal Revenue Service." Mr. Barmes attached to that letter copies of the Karl letter and the Felthaus letter, which Sovereignty included in its promotional materials and provided to petitioners.

On August 4, 1997, revenue agent Arnold responded in writing (revenue agent Arnold's letter dated August 4, 1997) to Mr. Barmes' letter dated May 16, 1997. Revenue agent Arnold's letter dated August 4, 1997, stated in pertinent part:

We have reviewed your response to our letter of May 14, 1997 requesting that you file trust returns for the Sandbar Real Estate Trust and the Sandbar Wholesale Trust. You replied by providing us with a letter from the Philadelphia Service Center stating that a "Pure Trust" organization has no filing requirements. We wish to advise you that the term "Pure Trust" is not used in the Internal Revenue Code. Whatever the name of the trust arrangement, the taxation of the entity must comply with the requirements of the Internal Revenue Code. These requirements are based upon the economic reality of the arrangement, not its nomenclature.

* * * * *

In your response to out [sic] letter dated May 1, 1997, you stated that no beneficiary disbursements were made and that no Forms K-1 were necessary. From this statement, we conclude that the trusts have not treated you as their owners, although it appears to us it should have done so. We note also that you did not report the trust income, deductions and credits on your personal return for 1995. Accordingly, the trusts are

required to file their own returns. With this law in mind, we request that you file Forms 1041 for the Sandbar Wholesale Trust and Sandbar Real Estate Trust with us on or before August 18, 1997.

In addition, we request that you provide us with the following documentation for the tax year ended December 31, 1995:

1. The case [sic] receipts and disbursements journals for each trust;

2. The checking and savings accounts for each trust (along with cancelled checks and deposit slips);

3. A copy of the managing agent's compensation agreement referred to in the trust agreement;

4. A copy of Schedule A and the Addendum referred to in each trust document; and

5. Any statements issued to you from the trusts informing you of the trusts' income, deductions and credits that you are required to report on your personal return for 1995 * * *.

On September 29, 1997, Mr. Barmes responded in writing (Mr. Barmes' letter dated September 29, 1997) to revenue agent Arnold's letter dated August 4, 1997. Mr. Barmes' letter dated September 29, 1997, stated in pertinent part:

The Service has filed notices of federal tax lien against the trusts, which are based on allegations that the trusts are alter egos, nominee agents, constructive trusts and/or transferees. The Service has further proceeded against Marvin and Barbara

Barmes as if they are partners, filed notices of federal tax lien based on this alleged partnership status, and apparently proceeded against Marvin and Barbara Barmes individually.

It should be readily apparent that it is the Service which has prevented us from filing appropriate forms at this time. Until the Service determines which legal theory pertains to us by taking a coherent position, our hands are tied. * * *

* * * We need your help or binding assurance that if the trusts file Form 1041's, then all filing requirements have been met. * * *

In that letter, Mr. Barmes further asserted that Sandbar Wholesale Trust and Sandbar Real Estate Trust were "contractual trusts", which he described as "not so much a trust as a contractual relationship based on trust form".

NOTICE OF DEFICIENCY

In the notice of deficiency (notice) issued to petitioners for 1995, respondent determined, inter alia, to increase the 1995 Schedule C gross receipts and consequently petitioners taxable income by $ 890,719. n32 With respect to those determinations, respondent stated in the explanation of adjustments (explanation) included in the notice: "in the absence of adequate books and records an indirect method was utilized to determine Gross Receipts". Exhibit C of the explanation further detailed the method that respondent used to determine the increase in petitioners' 1995 gross receipts, as follows:

----------Footnotes----------

n32 Although respondent determined to increase petitioners' taxable income for 1995 as a result of respondent's

determination to increase petitioners' Schedule C gross receipts for that year, for convenience we shall refer only to unreported gross receipts and not to unreported taxable income.

----------End Footnotes----------

	December 31, 1994
Total expense per 1994 Form 1040 as originally filed	$ 1,871,671
Gross profit per 1994 Form 1040 as originally filed	2,624,759
Total expense to gross profit percentage (divide item 1 by 2)	71.31%

	December 31, 1995
Total expense per 1995 Form 1040 as originally filed	$ 1,973,107
Total expense to gross profit percentage (see above)	71.31%
Corrected gross profit (divide item 4 by 5)	2,766,943
Amount per return	1,876,224
Adjustment to income	890,719

In the notice, respondent also determined, inter alia, to disallow the depreciation deductions of $ 9,400 that petitioners claimed in the 1995 Schedule C.

Respondent also determined in the notice that petitioners are liable for 1995 for the accuracy-related penalty under section 6662(a).

CERTAIN PRE-TRIAL CONDUCT OF PETITIONERS PETITIONERS' POSITION DURING INFORMAL DISCOVERY WITH RESPECT TO THE AUTOMOBILE DEPRECIATION DEDUCTIONS AT ISSUE

In Part V, Section A of Form 4562 attached to petitioners' 1995 joint return, petitioners indicated that they had written evidence to support the claimed business use during that year of petitioners' two automobiles. However, in a letter to respondent dated July 11, 2000, that petitioners wrote during the course of the parties' informal discovery in this case, petitioners indicated that they did not have any mileage logs or other documentation with respect to the business use during 1995 of those two automobiles. In another letter to respondent dated July 17, 2000, petitioners indicated that such documentation did not exist.

PETITIONERS' TRIAL MEMORANDUM

On September 12, 2000, petitioners submitted their trial memorandum (petitioners' trial memorandum) to the Court. In petitioners' trial memorandum, petitioners advanced, inter alia, various arguments and contentions challenging the jurisdiction and authority of the Court. On September 19, 2000, we issued an Order (September 19, 2000 Order) in which we directed that petitioners' trial memorandum be filed as of September 12, 2000, the date of its receipt by the Court. In that Order, we also stated that we found the arguments and contentions with respect to the jurisdiction and authority of the Court that petitioners advanced in petitioners' trial memorandum to be frivolous and/or groundless. We reminded petitioners in the September 19, 2000 Order about the provisions of section 6673(a)(1)(A) and (B), which allows the Court to require a taxpayer to pay a penalty to the United States whenever it appears to the Court that a proceeding before it has been instituted or maintained by the taxpayer primarily for delay or when the taxpayer's position in such a proceeding is frivolous or groundless. We informed

petitioners in the September 19, 2000 Order that "In the event that petitioners continue to advance frivolous and/or groundless contentions, the Court will be inclined to impose a penalty not in excess of $ 25,000 on petitioners under section 6673."

On October 2, 2000, petitioners filed a motion for clarification of the September 19, 2000 Order (petitioners' motion for clarification). In that motion, petitioners reasserted their arguments and contentions challenging the Court's jurisdiction and authority, which we had found in the September 19, 2000 Order to be frivolous and/or groundless. n33 On October 2, 2000, we denied petitioners' motion for clarification.

----------Footnotes----------

n33 In petitioners' motion for clarification, petitioners stated, inter alia:

> The Court has not provided any assistance to petitioners which would enable them to evaluate whether or not to pursue their issue(s), and petitioners seek guidance from the Court.*** the [September 19, 2000] Order was issued sua sponte, and petitioners have been provided no authority to examine which would explain why their position(s) is/are "frivolous and/or groundless."

----------End Footnotes----------

PETITIONERS' MOTION TO DISMISS

On October 16, 2000, three days after we issued the October 13, 2000 Order compelling petitioners to produce the requested documents of Sandbar Wholesale Trust and Sandbar Real Estate Trust to counsel for respondent and one week before the

date of trial in this case, petitioners filed a motion to dismiss (petitioners' motion to dismiss). In that motion, petitioners asked the Court to dismiss this case because the Court does not have jurisdiction over it. In support of petitioners' motion to dismiss, petitioners stated:

As grounds for this motion, petitioners would show the Court that the statutory notice of deficiency was not executed by the Commissioner of Internal Revenue.

The statutory notice of deficiency at issue in this case, although containing the Commissioner's name, was executed by "R. Arnold." * * *

Rule 13 of the United States Tax Court expressly provides that "the jurisdiction of the Court depends (1) in a case commenced in the Court by a taxpayer, upon the issuance BY THE COMMISSIONER of a notice of deficiency in income. . . ."

* * * the term Commissioner * * * means the Commissioner of Internal Revenue, personally.

On October 19, 2000, we issued an Order (October 19, 2000 Order) in which we denied petitioners' motion to dismiss. In that Order, we stated, inter alia:

The Court finds the * * * contentions of petitioners [advanced in their motion to dismiss] to be groundless and frivolous. The Court notes that petitioners continue to advance in this case what the Court finds to be frivolous and groundless contentions. See sec. 6673(a)(1); see also the Court's Order dated September 19, 2000.

OPINION

PRELIMINARY MATTERS

At trial, petitioners chose not to testify, did not call any other witnesses, and, except for the joint exhibits attached to the parties' stipulation of facts, introduced no documentary evidence into the record. Instead, in support of their position regarding the determination in the notice that they have unreported Schedule C gross receipts for 1995, petitioners advance, inter alia, the following arguments with respect to that determination: (1)(a) "the Commissioner must introduce some reasonable foundation supporting the tax deficiency in order to preserve the presumption of correctness", and (b) even if such a foundation exists, respondent's method of reconstructing petitioners' unreported Schedule C gross receipts for 1995 is arbitrary; and (2) respondent has the burden of proof. In support of their position regarding the determination in the notice disallowing the claimed 1995 Schedule C depreciation deductions with respect to petitioners' two automobiles, petitioners rely, inter alia, on certain facts that the Court found in *Barmes v. Commissioner, T.C. Memo. 2000-254,* affd. per curiam without published opinion *F.3d , 2001 U.S. App. LEXIS 14058* (7th Cir., June 19, 2001).

PETITIONERS' POSITION REGARDING THE PRESUMPTION OF CORRECTNESS

According to petitioners,

Unless some evidence supports an inference that the taxpayer was involved in the business alleged in the notice of deficiency during the period covered by the notice, "an assessment may not be supported even where the taxpayer is

silent." * * * .

* * * Therefore, before the Barmeses have any burden to present evidence in opposition to the Commissioner's deficiency notice, the Commissioner is required to present substantive evidence that the Barmeses received the unreported income asserted. Otherwise, the Commissioner is not entitled to a decision in its favor.

Here, there was no evidence showing the predicate fact that the Barmeses received the unreported income. * * * [Fn. ref. omitted.]

The U.S. Court of Appeals for the Seventh Circuit (Court of Appeals), the Court to which an appeal in this case would normally lie, has held:

All that is required to support the presumption [of correctness] is that the Commissioner's determination have some minimal factual predicate. It is only when the Commissioner's assessment is shown to be "without rational foundation" or "arbitrary and erroneous," that the presumption should not be recognized. * * *

Pittman v. Commissioner, 100 F.3d 1308, 1317 (7th Cir. 1996), affg. *T.C. Memo. 1995-243.* Although certain cases on which petitioners rely, see *United States v. McMullin, 948 F.2d 1188, 1192 (10th Cir. 1991),* and *Weimerskirch v. Commissioner, 596 F.2d 358, 360 (9th Cir. 1979),* revg. *67 T.C. 672 (1977),* mention the taxpayer's "receipt" of income, it is not necessary for the Commissioner to show the taxpayer's receipt of income in order to satisfy the requirement of the Court of Appeals (and other courts) that in unreported income cases the Commissioner's determination have some minimal factual predicate. In this connection, the Court of Appeals has

held that "The 'presumption of correctness' is appropriate where evidence existed which linked the taxpayers * * * with 'the tax-generating activity.'" *Gold Emporium, Inc. v. Commissioner, 910 F.2d 1374, 1378 (7th Cir. 1990),* affg. *Malicki v. Commissioner, T.C. Memo. 1988- 559.* See *Shriver v. Commissioner, 85 T.C. 1, 4 (1985),* affd. per Order (7th Cir. 1986).

The record in this case links petitioners throughout 1995, the year at issue, to the two businesses, Barbara's Gift Shop and Barmes Wholesale. That record establishes that throughout that year petitioners operated, controlled the operations of, and controlled those two tax-generating activities. The instant record also shows that the creation of Sandbar Wholesale Trust in October 1995 did not change petitioners' operation of, control over the operations of, or control over Barbara's Gift Shop and Barmes Wholesale.

Petitioners also contend that the method that respondent used in the notice to reconstruct petitioners' Schedule C gross receipts for 1995 is arbitrary. n34 On the instant record, we reject that contention. Petitioners refused to provide respondent with any information or documentation during respondent's examination of petitioners' 1995 joint return. Under such circumstances, respondent was authorized to reconstruct petitioners' income by any reasonable means which clearly reflects income. See, e.g., *Zuhone v. Commissioner, 883 F.2d 1317, 1326 (7th Cir. 1989),* affg. *T.C. Memo. 1988-142; Petzoldt v. Commissioner, 92 T.C. 661, 686-687 (1989).* On the record presented, we find respondent's method of reconstructing petitioners' 1995 Schedule C gross receipts and the results generated by that method to be reasonable. n35 In fact, the method used by respondent resulted in an amount of total Schedule C reconstructed gross receipts for 1995 which was less than the total sales from Barbara's Gift Shop and Barmes

Wholesale for 1995 (i.e., $ 5,799,767) that Mr. Barmes reported to the State of Indiana in the Indiana business tangible personal property assessment return that he filed for those businesses for that year. Under respondent's method of reconstructing petitioners' 1995 Schedule C gross receipts, the gross receipts from Barbara's Gift Shop and Barmes Wholesale for 1995 equaled only $ 5,107,781 (i.e., $ 4,217,046 (gross receipts of $ 4,217,062 less returns and allowances of $ 16 that were reported in petitioners' 1995 Schedule C) plus $ 890,719 (unreported 1995 Schedule C gross receipts determined in the notice)), which is almost $ 700,000 less than the total sales for Barbara's Gift Shop and Barmes Wholesale for 1995 that Mr. Barmes reported in the Indiana business tangible personal property assessment return. n36

----------Footnotes----------

n34 In order to reconstruct petitioners' 1995 Schedule C gross receipts, respondent divided the total expenses reported in petitioners' 1994 Schedule C (i.e., $ 1,871,671) by the gross profit (total net gross receipts (i.e., total gross receipts reduced by returns and allowances) minus cost of goods sold) reported in that schedule (i.e., $ 2,624,759). The resulting quotient was 71.31 percent. The revenue agent then divided the total expenses claimed in petitioners' 1995 Schedule C (i.e., $ 1,973,107) by that percentage. The result ($ 2,766,943) was determined to be the reconstructed Schedule C gross profit for 1995. Respondent determined that the difference (i.e., $ 890,719) between that reconstructed gross profit of $ 2,766,943 and the gross profit reported in petitioners' 1995 Schedule C (i.e., $ 1,876,224) constituted petitioners' unreported 1995 Schedule C gross receipts. (In this connection, petitioners do not claim any returns and allowances or cost of goods sold in excess of the amounts of such items claimed in petitioners' 1995

Schedule C.) Pursuant to the foregoing method of reconstructing petitioners' Schedule C gross receipts for 1995, respondent determined to increase petitioners' Schedule C gross receipts for that year by $ 890,719.

n35 The Court sustained a similar method of reconstructing income in *Markman v. Commissioner, T.C. Memo. 1987-407.*

n36 As respondent points out, the reasonableness of respondent's method of reconstructing petitioners' 1995 Schedule C gross receipts and the results produced by that method is also evidenced by the relationship of Schedule C gross profit to Schedule C gross receipts. The percentage of Schedule C gross profit to reported Schedule C gross receipts for 1994 was 48.2 percent (i.e., 1994 gross profit of $ 2,624,759 divided by total 1994 reported gross receipts of $ 5,445,178). If one were to use that percentage (i.e., 48.2 percent) in order to calculate 1995 total gross receipts, the result would be $ 5,740,546 (i.e., the 1995 gross profit determined in the notice of $ 2,766,943 divided by 48.2 percent). The recalculated total gross receipts for 1995, determined by using the 1994 percentage of gross profit to total 1994 reported gross receipts, is remarkably close to the total sales of $ 5,799,767 that Mr. Barmes reported in the Indiana business tangible personal property assessment return as the total sales of Barbara's Gift Shop and Barmes Wholesale for 1995.

----------End Footnotes----------

PETITIONERS' POSITION REGARDING THE BURDEN OF PROOF

Respondent advances the following alternative theories or principles in support of the determination in the notice to increase petitioners' Schedule C gross receipts for 1995: (1) The assignment of income theory; (2) sham trust principles; and (3)

the grantor trust rules found in sections 671-679 (grantor trust rules). The notice did not expressly mention any of the foregoing theories or principles. Consequently, according to petitioners, those theories and principles are new matters under Rule 142(a) on which respondent has the burden of proof.

We need not decide whether petitioners' position that respondent has the burden of proof regarding the alternative theories advanced by respondent in support of the determination in the notice to increase petitioners' Schedule C gross receipts for 1995 is correct. The record establishes that petitioners had unreported 1995 Schedule C gross receipts from Barbara's Gift Shop and Barmes Wholesale in the amount determined by respondent in the notice. We would reach the same result no matter who has the burden of proof on that issue.

PETITIONERS' RELIANCE ON FACTS FOUND IN BARMES V. COMMISSIONER, *T.C. Memo 2000-254*

In support of their position regarding the depreciation deductions at issue, it appears that petitioners are arguing that under the doctrine of collateral estoppel the Court is required to find as facts in this case the facts that we found in *Barmes v. Commissioner, T.C. Memo. 2000-254.* Barmes involved, inter alia, petitioners' claim to Schedule C depreciation deductions for 1994 with respect to petitioners' two automobiles, which we rejected. The instant case involves, inter alia, petitioners' claim to Schedule C depreciation deductions for 1995 with respect to those same two automobiles.

In *Commissioner v. Sunnen, 333 U.S. 591, 92 L. Ed. 898, 68 S. Ct. 715 (1948),* the Supreme Court examined and discussed the doctrine of collateral estoppel as it applies in Federal income tax cases. The Supreme Court stated in pertinent part:

Income taxes are levied on an annual basis. Each year is the origin of a new liability and of a separate cause of action. Thus if a claim of liability or nonliability relating to a particular tax year is litigated, a judgment on the merits is res judicata as to any subsequent proceeding involving the same claim and the same tax year. But if the later proceeding is concerned with a similar or unlike claim relating to a different tax year, the prior judgment acts as a collateral estoppel only as to those matters in the second proceeding which were actually presented and determined in the first suit. Collateral estoppel operates, in other words, to relieve the government and the taxpayer of "redundant litigation of the identical question of the statute's application to the taxpayer's status." * * *

* * * * *

* * * where two cases involve income taxes in different taxable years, collateral estoppel must be used with its limitations carefully in mind so as to avoid injustice. It must be confined to situations where the matter raised in the second suit is identical in all respects with that decided in the first proceeding and where the controlling facts and applicable legal rules remain unchanged. * * *

Id. at 598-600.

We reject petitioners' apparent attempt to rely on the doctrine of collateral estoppel to require us to find as facts in this case the facts that we found in *Barmes v. Commissioner, supra.* Any such attempt misconstrues and misapplies that doctrine. In determining here whether petitioners are entitled to the depreciation deductions that they are claiming for 1995 with respect to petitioners' two automobiles, we are in no way bound by the facts that we found in Barmes. In resolving the depreciation issue presented to us, we shall rely on the facts that

we have found are established by the record in this case, and not by the facts that we found in Barmes were established by the record in that case.

RESPONDENT'S DETERMINATION REGARDING PETITIONERS' CLAIMED SCHEDULE C GROSS RECEIPTS

During respondent's examination of petitioners' 1995 joint return, petitioners refused to provide respondent's revenue agent with any books, records, or other information with respect to the items of income and deduction reported by petitioners in that return. Consequently, respondent relied on the indirect method of reconstructing petitioners' 1995 Schedule C gross receipts described above. See, e.g., supra note 34. We have found that method and the results generated by that method to be reasonable. The only question that remains for our consideration is whether the unreported Schedule C gross receipts determined by respondent in the notice are taxable to petitioners. On the record before us, we find that they are.

As discussed above, respondent advances three alternative theories or principles in support of respondent's determination that petitioners had unreported Schedule C gross receipts for 1995: (1) The assignment of income theory; (2) sham trust principles; and (3) the grantor trust rules. We shall address only the assignment of income theory because that theory resolves against petitioners the issue of whether they are taxable on the unreported Schedule C gross receipts that respondent determined in the notice.

As we understand their position regarding the unreported Schedule C gross receipts at issue, petitioners contend that the income which Barbara's Gift Shop and Barmes Wholesale generated after Sandbar Wholesale Trust was created on October 12, 1995, is income that Sandbar Wholesale Trust

earned, and not income that petitioners earned. That is because, according to petitioners, after the creation of Sandbar Wholesale Trust on October 12, 1995, petitioners no longer held title to those two businesses or to the properties of those businesses.

Although the record shows that Sandbar Wholesale Trust was established on October 12, 1995, the record does not show that petitioners transferred Barbara's Gift Shop and Barmes Wholesale, or any properties of those businesses, to that trust on that date or at any other time during 1995. n37 On the instant record, we reject petitioners' contention that petitioners transferred Barbara's Gift Shop and Barmes Wholesale, or any properties of those two businesses, to Sandbar Wholesale Trust on October 12, 1995, or at any other time during the year at issue. n38

----------Footnotes----------

n37 The record shows that Mr. Barmes made initial cash deposits of $ 1,000 into each of the three Community Bank accounts that he opened on Oct. 13, 1995, with respect to Sandbar Wholesale Trust in the names of Sandbar Wholesale Trust -- Barbara [sic] Gift Shop, Sandbar Wholesale Trust -- Barmes Wholesale, and Sandbar Wholesales [sic] Trust -- Payroll. However, the record does not establish that the cash used to make those deposits was the property of Barbara's Gift Shop and/or Barmes Wholesale. The record does show that on Oct. 18, 1995, petitioners gratuitously transferred to Sandbar Real Estate Trust by warranty deed the Fritchton property and the two parcels of real estate on which the two business locations were situated. We express no opinion herein as to whether such transfers should be recognized for Federal tax purposes.

n38 The record establishes only that petitioners made certain claims to, inter alia, respondent and the State of Ind. that they transferred Barbara's Gift Shop and Barmes Wholesale and the properties of those two businesses to Sandbar Wholesale Trust. For example, the record includes a three-page document relating to the Sandbar Wholesale Trust that was filed with the Knox County Recorder's Office on October 12, 1995, which respondent obtained from that office. That document contained, inter alia, the following statement: "Trustee(s) have * * * acknowledged the conveyance, delivery and acceptance of certain * * * property listed in Schedule A and Addendum to be held in Trust according to the terms, herein." The record does not contain the Schedule A and Addendum to which the document in question referred. Nor does the record contain any other documents evidencing any alleged conveyance to Sandbar Wholesale Trust or any other trust documents relating to that trust. During respondent's examination of petitioners' 1995 joint return, petitioners did not provide respondent's revenue agent with any trust documents relating to Sandbar Wholesale Trust. During the discovery process in this case, petitioners refused to comply with the Court's October 13, 2000 Order compelling petitioners to produce to counsel for respondent, inter alia, any trust documents relating to Sandbar Wholesale Trust that respondent requested in respondent's request for production of documents. During the trial in this case, petitioners did not offer any such documents into the record.

----------End Footnotes----------

The record before us establishes that throughout 1995, including the period after the creation of Sandbar Wholesale Trust, petitioners operated, controlled the operations of, and controlled Barbara's Gift Shop and Barmes Wholesale. On that record, we find that throughout 1995 petitioners controlled the

earning of the income of those two businesses. Consequently, regardless of whether petitioners transferred the two businesses and/or the properties of those businesses to Sandbar Wholesale Trust after it was created, on the instant record, petitioners are taxable under the assignment of income doctrine on the unreported 1995 Schedule C gross receipts at issue in this case. See *Lucas v. Earl, 281 U.S. 111, 74 L. Ed. 731, 50 S. Ct. 241 (1930).*

The "first principle of income taxation" is that income must be taxed to the one who earns it. *Commissioner v. Culbertson, 337 U.S. 733, 739-740, 93 L. Ed. 1659, 69 S. Ct. 1210 (1949)* (citing Lucas v. Earl, supra). Attempts to subvert this principle by diverting income away from its true earner to another entity by means of contractual arrangements, however cleverly drafted, are not recognized as dispositive for Federal income tax purposes, regardless of whether such arrangements are otherwise valid under State law. See *Vercio v. Commissioner, 73 T.C. 1246, 1253 (1980);* see also *Schulz v. Commissioner, 686 F.2d 490, 493 (7th Cir. 1982),* affg. *T.C. Memo. 1980-568.* The "true earner" of income is the person or entity who controlled the earning of such income, rather than the person or entity who received the income. See *Vercio v. Commissioner, supra at 1253* (citing *Wesenberg v. Commissioner, 69 T.C. 1005, 1010 (1978));* see also *Commissioner v. Sunnen, 333 U.S. at 604* (" The crucial question remains whether the assignor retains sufficient power and control over the assigned property or over receipt of the income to make it reasonable to treat him as the recipient of the income for tax purposes.").

Even if, as petitioners contend, they transferred Barbara's Gift Shop and Barmes Wholesale and/or the properties of those businesses to Sandbar Wholesale Trust after it was created, based on our examination of the entire record before us, we find that petitioners' attempt to divert the income of those two

businesses to Sandbar Wholesale Trust constituted an invalid assignment of income. Consequently, we sustain respondent's determination that petitioners have unreported Schedule C gross receipts for 1995 in the amount of $ 890,719.

RESPONDENT'S DETERMINATION REGARDING PETITIONERS' CLAIMED DEPRECIATION DEDUCTIONS

In the notice, respondent disallowed the depreciation deductions that petitioners claimed in the 1995 Schedule C with respect to petitioners' two automobiles.

Deductions are strictly a matter of legislative grace, and petitioners bear the burden of proving that they are entitled to any deductions claimed. See *INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 84, 117 L. Ed. 2d 226, 112 S. Ct. 1039 (1992).*

Section 167(a) allows a deduction for a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business or held for the production of income. Section 274(d)(4) operates to disallow any deduction otherwise allowable under, inter alia, section 167 with respect to, inter alia, any "listed property" unless the taxpayer satisfies the substantiation requirements of that section. n39 "Listed property" is defined in section 280F(d)(4) to include passenger automobiles. See sec. 280F(d)(4)(A)(i). As pertinent here, petitioners may satisfy the substantiation requirements of section 274(d) and the regulations thereunder by adequate records or by sufficient evidence corroborating their own statements. See sec. 274(d)(4); sec. 1.274- 5T(c)(1), Temporary Income Tax Regs., *50 Fed. Reg. 46016-46017* (Nov. 6, 1985).

----------Footnotes----------

n39 Sec. 274(d) provides in pertinent part:

SEC. 274. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES.

(d) Substantiation Required. -- No deduction or credit shall be allowed --

* * * * *

(4) with respect to any listed property (as defined in section 280F(d)(4)), unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement (A) the amount of such expense or other item, (B) the time and place of the * * * use of the facility or property * * *, (C) the business purpose of the expense or other item * * *.

----------End Footnotes----------

In support of the automobile depreciation deductions at issue, petitioners rely on certain facts that we found in *Barmes v. Commissioner, T.C. Memo. 2000-254,* and on certain factual allegations not supported by the record that they advance in their briefs. We rejected above petitioners' reliance on certain facts that we found in *Barmes, supra.* We also reject petitioners' reliance on certain factual allegations in their briefs. See Rule 143(b). On the record before us, we find that petitioners have failed to establish that they used petitioners' two automobiles in a trade or business or that they held such automobiles for the production of income. See sec. 167(a).

Assuming arguendo that petitioners had established that they used petitioners' two automobiles in a trade or business or that they held such automobiles for the production of income, petitioners must satisfy the substantiation requirements of section 274(d)(4) and the regulations thereunder. Petitioners

concede that they kept no records with respect to the business use of petitioners' two automobiles. Consequently, petitioners may establish their entitlement to the depreciation deductions at issue only by introducing into the record in this case their own statements and sufficient evidence corroborating such statements. See sec. 274(d)(4); *sec. 1.274-5T(c)(1), Temporary Income Tax Regs., 50 Fed. Reg. 46017* (Nov. 6, 1985). Petitioners introduced no evidence at trial that supports their position with respect to the depreciation deductions at issue. On the instant record, we find that petitioners have failed to establish that they satisfy the substantiation requirements of section 274(d)(4) and the regulations thereunder regarding those deductions.

Based on our examination of the entire record before us, we find that petitioners have failed to establish their entitlement to the depreciation deductions at issue. Consequently, we sustain respondent's determination with respect to those claimed deductions.

RESPONDENT'S DETERMINATION REGARDING THE ACCURACY-RELATED PENALTY UNDER SECTION 6662(a)

In the notice, respondent determined that petitioners are liable for the year at issue for the accuracy-related penalty under section 6662(a) and asserted the following alternative grounds for the imposition of that penalty: Negligence under section **[*110]** 6662(b)(1) and a substantial understatement of income tax under section 6662(b)(2).

Petitioners bear the burden of proving that they are not liable for the accuracy-related penalty under section 6662(a). See Rule 142(a); *Welch v. Helvering, 290 U.S. 111, 115, 78 L. Ed. 212, 54 S. Ct. 8 (1933).*

Section 6662(a) imposes an accuracy-related penalty equal

to 20 percent of the underpayment resulting from, inter alia, negligence or disregard of rules or regulations, see section 6662(b)(1), or a substantial understatement of income tax, see section 6662(b)(2). For purposes of section 6662(a), the term "negligence" includes any failure to make a reasonable attempt to comply with the Code, and the term "disregard" includes any careless, reckless, or intentional disregard. See sec. 6662(c). Negligence has also been defined as a lack of due care or failure to do what a reasonable person would do under the circumstances. See *Leuhsler v. Commissioner, 963 F.2d 907, 910 (6th Cir. 1992),* affg. *T.C. Memo. 1991-179; Antonides v. Commissioner, 91 T.C. 686, 699 (1988),* affd. *893 F.2d 656 (4th Cir. 1990).* An understatement is equal to the excess of the amount of tax **[*111]** required to be shown in the tax return over the amount of tax shown in the tax return, see sec. 6662(d)(2)(A), and is substantial in the case of an individual if it exceeds the greater of 10 percent of the tax required to be shown or $ 5,000, see sec. 6662(d)(1)(A).

The accuracy-related penalty under section 6662(a) does not apply to any portion of an underpayment if it is shown that there was reasonable cause for, and that the taxpayer acted in good faith with respect to, such portion. See sec. 6664(c)(1).

Petitioners introduced no evidence and advance no contentions with respect to the accuracy-related penalty under section 6662(a). On the record before us, we find that petitioners have failed to show that they were not negligent and did not disregard rules or regulations within the meaning of section 6662(b)(1), or otherwise did what a reasonable person would do, with respect to any portion of the underpayment for 1995. On that record, we further find that petitioners have failed to show that they acted with reasonable cause and in good faith with respect to any portion of the underpayment for that year. n40 See sec. 6664(c).

----------Footnotes----------

n40 We also find on the record before us that there is a substantial understatement of tax under sec. 6662(b)(2). Petitioners showed no tax in petitioners' 1995 joint return. The tax required to be shown in that return, as calculated by respondent in the notice, is $ 315,478, and we have sustained all of respondent's determinations in the notice.

----------End Footnotes----------

Based on our examination of the entire record before us, we find that petitioners have failed to establish any error in respondent's determination that they are liable for the year at issue for the accuracy-related penalty under section 6662(a). Accordingly, we sustain respondent's determination with respect to that penalty.

PENALTY UNDER SECTION 6673(a)(1)

On brief, respondent asks the Court to require petitioners to pay a penalty to the United States pursuant to section 6673(a)(1).

Section 6673(a)(1) authorizes the Court to require a taxpayer to pay to the United States a penalty in an amount not to exceed $ 25,000 whenever it appears to the Court that, inter alia, the taxpayer's position in a proceeding before it is frivolous or groundless. See sec. 6673(a)(1)(B). The Court may impose a penalty under section 6673(a)(1)(B) even if it finds that not all of the taxpayer's arguments are frivolous or groundless. See *Sloan v. Commissioner, 102 T.C. 137, 148 (1994)*, affd. *53 F.3d 799 (7th Cir. 1995)*.

A position is frivolous when it is "contrary to established

law and unsupported by a reasoned, colorable argument for change in the law." *Coleman v. Commissioner, 791 F.2d 68, 71 (7th Cir. 1986).* The word "groundless" is a word of common usage. Webster's Third New International Dictionary Unabridged 1003 (1993) provides the following definition of that word: "having no ground or foundation: lacking cause or reason for support".

In support of respondent's position that the imposition on petitioners of a penalty under section 6673(a)(1) is appropriate, respondent points to (1) petitioners' trial memorandum that the Court had filed as of September 12, 2000, the date of its receipt by the Court, (2) the Court's September 19, 2000 Order directing that that trial memorandum be filed, (3) petitioners' motion to dismiss filed on October 16, 2000, and (4) the Court's October 19, 2000 Order denying that motion. In the September 19, 2000 Order, we stated that we found the arguments and contentions with respect to the jurisdiction and authority of the Court that petitioners advanced in petitioners' trial memorandum to be frivolous and/or groundless. We also reminded petitioners in the September 19, 2000 Order about section 6673(a)(1) and informed them that "In the event that petitioners continue to advance frivolous and/or groundless contentions, the Court will be inclined to impose a penalty not in excess of $ 25,000 on petitioners under section 6673." In the October 19, 2000 Order, we found the contentions of petitioners that the Court lacks jurisdiction over the instant case because the notice issued to petitioners was not personally signed by the Commissioner of Internal Revenue to be frivolous and groundless. We further noted in the October 19, 2000 Order that petitioners were continuing to advance in this case what we found to be frivolous and groundless contentions, and we cited in that Order our September 19, 2000 Order, in which we indicated that we would be inclined to impose a penalty under

section 6673 in the event that petitioners continued to advance frivolous and/or groundless contentions.

According to respondent, after the Court issued the September 19, 2000 Order, in which we found the arguments and contentions with respect to the Court's jurisdiction and authority that petitioners advanced in their trial memorandum to be frivolous and/or groundless and in which we reminded petitioners about section 6673(a)(1), petitioners continued to advance contentions in their motion to dismiss filed on October 16, 2000, which the Court found in the October 19, 2000 Order to be frivolous and groundless. Consequently, respondent argues, the Court should impose a penalty on petitioners under section 6673(a)(1).

Petitioners do not address the reasons advanced by respondent in support of respondent's position that the Court should impose a penalty under section 6673(a)(1). Instead, petitioners argue that the imposition of such a penalty is not appropriate in the instant case because they refrained from presenting at trial and on brief (1) the same arguments and contentions challenging the Court's jurisdiction and authority that they had advanced in petitioners' trial memorandum and (2) "any challenge whatsoever to the Court's jurisdiction and authority."

On the record before us, we reject petitioners' position. Petitioners first appear to be taking the position that the September 19, 2000 Order cautioned petitioners only against continuing to advance the specific arguments and contentions which they had presented in their trial memorandum and which we found in that Order to be frivolous and/or groundless. Any such position ignores the September 19, 2000 Order. That Order stated: "In the event that petitioners continue to advance frivolous and/or groundless contentions, the Court will be inclined to impose a penalty not in excess of $ 25,000 on

petitioners under section 6673." The September 19, 2000 Order did not advise petitioners that the Court will be inclined to impose a penalty under section 6673 only in the event that they continue to advance the same arguments and contentions that they presented in their trial memorandum.

Petitioners also appear to be taking the position that we should not impose a penalty under section 6673(a)(1) because they refrained from making any challenge whatsoever to the Court's jurisdiction and authority at trial and on brief. That position ignores the reasons that respondent advances on brief in support of the imposition of a penalty under section 6673(a)(1). Those reasons are that, after we informed petitioners in the September 19, 2000 Order that we would be inclined to impose a penalty under section 6673(a)(1) if they continued to advance frivolous and/or groundless contentions, petitioners continued to advance frivolous and groundless contentions challenging the Court's jurisdiction in petitioners' motion to dismiss that they filed on October 16, 2000. We agree that the reasons presented by respondent warrant imposition in the instant case of a penalty under section 6673(a)(1).

By continuing to assert after the Court issued the September 19, 2000 Order frivolous and groundless contentions in the motion to dismiss that petitioners filed on October 16, 2000, petitioners consumed the time and effort of the Court, which otherwise could have been devoted to resolving bona fide claims of other taxpayers. See *Coleman v. Commissioner, supra at 72; Cook v. Spillman, 806 F.2d 948 (9th Cir. 1986),* affd. per curiam. Based on our examination of the entire record before us, we find that, pursuant to section 6673(a)(1)(B), the imposition of a penalty in the amount of $ 2,000 is appropriate in this case.

We have considered all of the contentions and arguments of petitioners that are not discussed herein, and we find them to be

without merit and/or irrelevant.

To reflect the foregoing,

An appropriate order will be issued and a decision will be entered sustaining respondent's determinations and imposing a penalty under section 6673(a)(1).